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Division of Swap Dealer and
Intermediary Oversight

Gary Barnett
Director

CFTC Letter No. 12-01
Interpretation
February 27, 2012
Division of Swap Dealer and Intermediary Oversight

Regina Thoele
Senior Vice-President, Compliance
National Futures Association
300 South Riverside Plaza, Suite 1800
Chicago, Illinois 60606

Re: Request for Interpretive Guidance – CFTC Regulations 4.34 and 4.35
Performance Disclosure for Forex CTAs

Dear Ms. Thoele:

This is in response to your letter dated September 13, 2011. By your letter you sought guidance regarding the obligation to disclose past performance where a commodity trading advisor ("CTA") has discretionary trading authority over the account of a person other than an eligible contract participant (as defined in the Commodity Exchange Act[1]) in connection with off-exchange retail foreign currency transactions ("retail forex").

Specifically, you sought the Division's view regarding the point in time from which a person who is required to be registered as a CTA because the person directs accounts that engage in retail forex transactions (a "Forex CTA") must disclose the performance of those accounts (whether performance disclosure must be made, e.g., for the five most recent calendar years and year-to-date preceding the date of the Forex CTA's Disclosure Document (or the life of the trading program if shorter) as required under Regulation 4.35(a)(5);[2] for the period from the June 18, 2008 enactment of the statutory provision requiring registration of Forex CTAs;[3] or for the period from the October 18, 2010 effective date of the Commission's regulations (the "Forex Regulations") that it adopted to implement the statutory registration requirement.[4]

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1 7 U.S.C. § 1, *et seq*. (2006). The Commodity Exchange Act (the "Act") may be accessed at the Commission's website, http://www.cftc.gov.

2 Commission regulations are found at 17 C.F.R. Ch. I (2011) and may also be accessed at the Commission's website, http://www.cftc.gov.

3 *See* the CFTC Reauthorization Act of 2008 ("CRA"), Title XIII of the Food, Conservation, and Energy Act of 2008, Public Law 110–246, 122 Stat. 1651, 2189–2204 (2008)..

4 *See* 75 Fed. Reg. 55410 (Sep. 10, 2010).

Among other things, the Forex Regulations: (1) generally require that any person who exercises discretionary trading authority over an account engaged in retail forex transactions must register as a CTA (Regulations 5.1(e)(1) and 5.3(a)(3)(i)); and (2) subject each such person to Part 4 of the Commission's regulations, which includes Regulations 4.31, 4.34, 4.35 and 4.36, applicable to CTA Disclosure Documents.

Part 4 of the regulations includes, among other things, performance disclosure requirements. The Commission first proposed to require CTAs to disclose their past performance in 1977, in connection with establishing a comprehensive program for the regulation of CTAs and commodity pool operators ("CPOs"). In doing so, the Commission stated:

> A knowledge of the background and experience of a trading advisor appears essential to a meaningful prospective evaluation of the value of the advisor's services. Commodity trading is a complex field, requiring substantial skill and knowledge. A prospective client or subscriber should be aware of the advisor's commodity and general business experience if he is to make an informed decision as to whether or not to avail himself of the advisor's services.[5]

The Commission added in a footnote:

> The Commission recognizes that this requirement [to disclose past performance information] may impose substantial burdens on certain trading advisors. Because no requirement now exists to maintain such performance records and because such information may be more accessible to the futures commission merchants carrying such accounts, the effective date of any requirement for trading advisors to disclose past account performance might be structured to permit them to comply with such a requirement by keeping such performance records from the date these proposed regulations are adopted.[6]

When final regulations were adopted two years later, the Commission had determined not to require disclosure of a CTA's past performance. If a CTA chose to present such information, though, it had to do so in the same format as the performance information CPOs were required to use.

> The Commission is not adopting the requirement in the proposed rule (§ 5.2(b)(2)) that CTAs disclose the performance of commodity interest accounts controlled by the CTA or any principal thereof within the previous year. Commentators stated that this information would be expensive to compile and would not be meaningful because clients often countermand the CTA's trading

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5 *See* 42 Fed. Reg. 9278, 9279 (Feb. 15, 1977).

6 *Id.* n. 14.

> decisions. The Commission agrees with these comments and instead is requiring CTAs to disclose whether they control accounts and whether clients may obtain information about the performance of those accounts.[7]

The Commission revisited the question when it revised the CPO and CTA regulations in 1981 and concluded that it made sense to harmonize the disclosure requirements for CPOs (who were required to disclose past performance) with those for CTAs. Accordingly, CTAs were required to disclose the actual performance for the advisor and for each principal for the three years preceding the date of the Disclosure Document. The Commission stated:

> With respect to CTAs, as proposed and as adopted, a CTA must disclose the past performance of all accounts (including pools) directed by the CTA and its principals. Section 4.31(a)(3)(i). The comments the Commission received were mixed. Those persons who supported the proposal stated that, among other things, they agreed with harmonizing the past performance disclosure required of CTAs with that required of CPOs Those who opposed the proposal stated that, among other things, it could lead to cumbersome and unnecessarily lengthy performance tables. This concern has been addressed, in part, in the rules on compositizing past performance, discussed below. Moreover, the Commission believes that to fulfill the purposes of the Disclosure Document rules, it is essential that this performance be disclosed. The Disclosure Document is intended to provide protection for commodity customers – particularly those who are unsophisticated in financial matters – by ensuring that they are informed about material facts before committing their funds. See 44 FR 19178, 1920 (January 8, 1979). Because a CTA's past performance is a material fact about which a prospective client should be informed, the record of that past performance should be disclosed.[8]

When the CPO and CTA disclosure regulations were amended in 1995, the current requirement to disclose performance for a period of five calendar years and year-to-date was adopted. The Commission stated its belief that:

> requiring performance to be disclosed for a period longer than three years will make the timespan covered by performance disclosures more uniform and will better portray the evolution of performance over time, including positive and negative fluctuations.[9]

Prior to the adoption of the Forex Regulations, the Commission did not require a person who exercised discretionary trading authority over accounts engaged in retail forex transactions

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7 *See* 44 Fed. Reg. 1918, 1923 (January 8, 1979).

8 *See* 46 Fed. Reg. 26004, 26009 (May 8, 1981).

9 *See* 60 Fed. Reg. 38146, 38160-38161 (July 25, 1995).

(and who did not accept or hold client money in the course of providing advice or managing accounts) to register with it as a CTA. Further, the Commission did not require that such a person provide a Disclosure Document containing past performance information, or maintain supporting documents to substantiate the computation of past performance information.[10] These requirements first became applicable to Forex CTAs when the Forex Regulations became effective. Also, upon effectiveness of the Forex Regulations each futures commission merchant or retail foreign exchange dealer first became required by Regulation 5.13(c) to make the monthly and confirmation statements that it must send to a retail forex customer available to any person (such as a Forex CTA) who controls the retail forex customer's account. Accordingly, we believe that a Forex CTA should not be required to reconstruct and present in its disclosure document past performance information for any period preceding the October 18, 2010 effective date of the regulations that first established a requirement for such information.

It is the Division's view, then, that a Forex CTA is required to disclose past performance for the period beginning October 18, 2010, or, if later, the date on which the Forex CTA first began exercising discretionary trading authority over accounts engaged in retail forex transactions. From and after October 18, 2015, the period of time described in Regulation 4.35(a)(5) (five most recent calendar years and year-to-date or life of the trading program, if shorter) would apply.

If a Forex CTA elects to include in its Disclosure Document past performance information for any time prior to October 18, 2010, we believe that in order to avoid "cherry picking" the presentation of such information should encompass the entire period set forth in Regulation 4.35(a)(5) and should include all of the accounts over which the Forex CTA exercised discretionary trading authority during that period. Further, any such past performance information would have to be presented in accordance with the requirements of Part 4 and be supported by adequate documentation as required by Regulation 4.35(a)(6)(ii).

You also sought guidance concerning a Forex CTA's business background disclosure for periods during which the Forex CTA's Disclosure Document does not present performance information. The Division's view is that the five-year period for business background disclosure specified in Regulation 4.34(f) should apply whether or not that period begins prior to October 18, 2010, because that information is material to prospective clients, is known to the Forex CTA, and does not have to be obtained from others or specifically documented. If, however, the business background section of a Forex CTA's Disclosure Document includes discussion of the experience of the Forex CTA (or any of its trading principals) directing accounts during any portion of the period set forth in Regulation 4.35(a)(5) for which the Disclosure Document does not contain past performance (presented and documented in the manner required in Part 4) our view is that the discussion should be restricted to identifying the person's employment, and it

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[10] Regulation 4.35(a)(6)(ii) requires making and keeping of such supporting documents for past performance calculations. Regulation 5.4 makes the requirements of Part 4 of the Commission's regulations applicable to persons required by Regulation 5.3(a)(3)(i) to register as CTAs.

should not include any qualitative description of the person's success or ability in directing accounts during that time (except where negative performance results constitute material information for which disclosure is required under Regulation 4.34(o)). Moreover, in such a case, the business background section should include a statement that although Regulation 4.35 generally requires a CTA to disclose its actual performance for the most recent five years and year-to-date, the Forex CTA is not required to disclose past performance information for any time prior to October 18, 2010.

In response to a further question raised in your letter, the Division believes that the requirement to disclose material litigation within five years of the date of the Disclosure Document should apply regardless of whether the Forex CTA is able to provide past performance information. Litigation information is a matter of public record, and is material to a prospective client's decision to engage the Forex CTA. It is not necessarily related to trading performance, or the ability to present and substantiate performance information. (Similarly, information of a person's prior business associations is material information to potential investors, and it need not provide an indirect way to claim successful trading performance in the absence of proper past performance information.) Accordingly, the five-year time period should apply both for business background (as qualified in the preceding paragraph) and for material litigation.

This letter does not excuse a Forex CTA relying on the interpretation[11] set forth herein from compliance with any other requirements applicable to it contained in the Act or in the Commission's regulations issued thereunder. For example, the Forex CTA remains subject to applicable antifraud and registration provisions of the Act and the Commission's regulations, and to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's regulations. Further, this letter represents the views of this Division only and does not necessarily represent the position of the Commission or of any other office or division of the Commission.

If you have any questions concerning this correspondence, please contact Christopher W. Cummings, Special Counsel, at (202) 418-5445.

Sincerely,

Gary Barnett
Director

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[11] *See* Regulation 140.99(a)(3), which states that "[a]n interpretative letter may be relied upon by persons in addition to the Beneficiary."