CFTC Letter No. 00-84

December 23, 1999

Other Written Communication

Division of Trading & Markets

Re: Request for Clarification of Disclosure Document Delivery Requirement

---

Dear :

This is in response to your letter dated July 16, 1999, to the Division of Trading and Markets (the "Division") of the Commodity Futures Trading Commission (the "Commission"), as supplemented by your letters dated September 13, 1999 and October 12, 1999. By your correspondence, you request, on behalf of "X", a registered introducing broker ("IB"), commodity pool operator ("CPO") and commodity trading advisor ("CTA"), that the Division clarify the application of the Disclosure Document delivery requirement in the context of the operation by "X" of an Internet website containing past performance and other information on other CTAs.

Based upon the representations made in your correspondence, we understand the facts to be as follows. "X" derives most of its income from brokerage commissions earned in its capacity as an IB. Its customers are primarily institutional accounts and high net worth individuals.[1] Nearly all of "X's" accounts are managed by third-party CTAs.

"X's" website contains information regarding over one hundred CTAs. The information for each CTA includes a trading program description and certain specific items (largest drawdown, program start date, margin-to-equity ratio, management/incentive fees, minimum account size and round turns per year). Also included is a VAMI (value added monthly index) chart to show the change over a period of time of the value of a hypothetical $1,000 investment in the CTA's trading program. "X" also presents comparative charts of the performance of the various CTAs, and a ranking of the top thirty CTAs. If a visitor to "X's" website ultimately opens a commodity interest trading account with "X", in addition to earning brokerage commissions, "X" may also receive a portion of the CTA's management or incentive fees.[2]

Representatives of the National Futures Association ("NFA"), citing the Commission's *Interpretation Regarding Use of Electronic Media By Commodity Pool Operators and Commodity Trading Advisors for Delivery of Disclosure Documents and Other Materials* (the "1997 Interpretation"),[3] have advised

"X" that, under Commission Rule 4.31, "X" is obliged to make available at its website the Disclosure Document of each of the CTAs for which the website contains past performance information.

You claim that "X" has no obligation to deliver or to make available the Disclosure Documents of the CTAs whose performance it describes on its website. You further claim that "X" is not required to include on its website a summary risk disclosure statement as prescribed in the 1997 Interpretation.[4]

The Division does not agree with your position. The potential for direct compensation to "X" in the event that a customer opens an account with it that will be traded by one of the CTAs featured on "X's" website involves "X" in the process of soliciting clients for that CTA. The CTA itself would not be permitted to present on its own website the information with respect to itself that "X" presents without posting the summary risk disclosure statement contemplated by the 1997 Interpretation and without making its Disclosure Document easily available (*e.g.*, by hyperlink).[5] By the same token, the CTA should not be able to present that information (unaccompanied by the summary risk disclosure statement and the Disclosure Document) indirectly through the intermediation of "X". Accordingly, the Division believes that at a minimum "X" is required: (1) to post on its website the summary risk disclosure statement prescribed by the 1997 Interpretation; (2) to ensure that any information on its website, including past performance information regarding third-party CTAs, is accurate and not misleading;[6] and (3) in each instance in which there is any sharing of fees or other direct compensation of "X" by a CTA described on "X's" website, to make the CTA's Disclosure Document easily available on "X's" website.

The Commission and the NFA are continuing to evaluate the issues that arise from fact situations such as the one you have presented involving "X", and you may be contacted in the future in this connection. Whether or not you are so contacted, in the event that the Commission and/or the NFA adopt rules or issue guidance affecting the inclusion of CTA information on an IB's Internet website, you will be required to comply with those rules.

If you have any questions concerning this correspondence, please contact Christopher Cummings, an attorney on my staff, at (202) 418-5445.

Very truly yours

John C. Lawton
Acting Director

---

1 At the present time, all of "X's" customers are non-United States persons within the meaning of

Commission Rule 4.7, although "X" does accept accounts of United States persons. "X" does not currently manage accounts or operate commodity pools, although it may do so in the future. Commission rules referred to herein are found at 17 C.F.R. Ch. I (1999).

2 Although your correspondence is not entirely clear regarding the precise circumstances in which "X" will receive a portion of the CTA's fees, the fact that fee-sharing may occur distinguishes "X" from a neutral compiler and presenter of statistics regarding CTAs.

3 62 Fed. Reg. 39104 (July 22, 1997).

4 Although you contend that "X" is not required to post the summary risk disclosure statement, you state nevertheless that "X" agrees to include it on the website.

5 62 Fed. Reg. 39104, 39107-08, 39109, 39113.

6 Examples of misleading practices include "cherry picking," and (except as permitted under Commission and/or NFA rules) the presentation of hypothetical trading results and performance of proprietary accounts. In this regard, with respect to CTAs (and CPOs) presenting their own performance, the Commission has previously stated (without thereby excluding other potentially misleading practices) that the following are prohibited:

> (1) references only to successful trades, if during the same time period, trades which were unsuccessful were also recommended or executed; (2) references to the results during a specific time period, if the results claimed were not fairly representative of results achieved for comparable periods; (3) suggestions, assurances or claims of profit potential that do not also fairly present the possibility of loss; (4) statements of opinions or predictions which are not clearly labeled as such or which have no reasonable basis in fact; and (5) failure to disclose whether, and to what extent, fees, commissions and other expenses are reflected in the past performance results. 46 Fed. Reg. 26004, 26012 (May 8, 1981).