



U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5430
Facsimile: (202) 418-5536

96-70

DIVISION OF TRADING & MARKETS

September 18, 1996

Re: CTA Registration Requirements

Dear :

This is in response to your letter dated August 5, 1996 to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by telephone conversations with Division staff. By your correspondence, you request our advice as to whether your firm, "X", would be required to register as a commodity trading advisor ("CTA") in connection with providing certain advisory services, as more fully described below.

Based upon the representations made in your letter and in subsequent conversations with Division staff, we understand the pertinent facts to be as follows. "X" is in the process of being incorporated, and will have as its primary objectives the following: (1) to offer courses in financial engineering and designing of custom, non-standard derivative securities contracts to institutional investors; (2) to offer consulting services to end-users of derivative securities contracts, such as corporate treasurers and risk managers; (3) to host seminars for the general public on the use of options, including options on futures; (4) to demonstrate software designed by individuals at your firm to the general public, where such software entails quantifying and calculating certain risk parameters; and (5) to provide a dial-up phone service for individual and institutional investors on the risk parameters of a given option or security. We further understand that your firm will not be handling any client accounts, on a discretionary basis or otherwise.

Section 4m(1) of the Commodity Exchange Act (the "Act")^{1/} prohibits a person^{2/} from using the mails or any means or

^{1/} 7 U.S.C. §1 et seq. (1994).

^{2/} The Act defines a "person" to include, in the singular or plural form, individuals, associations, partnerships, corporations, and trusts.

instrumentality of interstate commerce in connection with his business as a CTA, unless registered as such under the Act. As defined in Section 1a(5) of the Act, a CTA is "any person who, for compensation or profit," advises others about trading in commodity futures or commodity option contracts "either directly or through publications, writings or electronic media" or who as a part of a regular business "issues or promulgates analyses or reports" concerning such transactions. An individual or firm may provide commodity trading advice by recommending specific transactions or trading methodologies or may simply advise generally about the value of trading in futures or commodity options, and in either case, be subject to registration as a CTA. Furthermore, a person may provide commodity trading advice even though he is "neither directly or indirectly involved in the solicitation of funds or trades or the trading of accounts."^{3/}

The statutory definition of a CTA explicitly refers to both direct and indirect forms of providing such advice. Thus, Commission staff in interpreting Section 1a(5) of the Act has found the CTA definition also applicable to persons distributing computer software programs that generated commodity trading recommendations or strategies^{4/} and those operating telephone hotlines that provided research and trade ideas.^{5/} Persons who engage in these activities, or others of the nature set forth in the definition, must register as a CTA, absent an exclusion or exemption. Section 1a(5) excludes certain persons from the definition of a CTA if they have furnished advisory services in a manner solely incidental to the conduct of specified businesses or professions. In addition, Section 4m(1) of the Act and Commission Rule 4.14^{6/} exempt certain other persons from CTA registration. Copies of the sections and rules referred to herein as well the interpretative letters listed below have been enclosed for your reference.

^{3/} See Division of Trading and Markets Interpretative Letter No. 96-56 [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,761 (July 8, 1996).

^{4/} See CFTC Interpretative Letter No. 93-18, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,694 (February 23, 1993) and CFTC Interpretative Letter No. 94-51, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. ¶ 26,115 (May 10, 1994).

^{5/} See CFTC Interpretative Letter No. 93-43, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,734 (May 19, 1993).

^{6/} Commission rules referred to herein are found at 17 C.F.R. Ch. I (1996).

Based upon the representations you have made to us, we do not believe that an exclusion from the CTA definition or exemption from CTA registration is available to "X". Thus, "X" would be required to be registered with the Commission as a CTA, and certain individuals of the firm listed as principals. Such individuals would include, but not be limited to, officers of "X" or those who have contributed ten percent or more of its capital.^{7/} The Commission has delegated the processing of registration applications to the National Futures Association ("NFA"). You may contact NFA for further information and forms at the following address:

National Futures Association
200 West Madison Street, Suite 1600
Chicago, Illinois 60606
(312) 781-1300
From outside of Illinois: 1-800-621-3570.

Based upon your representations, it does not appear that "X" will have discretionary trading authority over client accounts. If that is the case, persons soliciting clients on its behalf will not be required to be registered as associated persons of "X" or to take and pass the Series 3 exam.^{8/} Further, "X" will not be required to become a member of the NFA^{9/}, and persons soliciting clients on its behalf will not be required to become NFA associates based solely upon that activity. Finally, "X" will not be required to

^{7/} The term "principal" is defined in Rule 3.1, a copy of which is enclosed for your reference.

^{8/} Principals must, however, submit fingerprints for clearance in connection with the registration application.

^{9/} The registration requirements under the Act and the requirements for membership in the NFA are not identical with respect to persons acting as CTAs. Commission Rule 170.15 requires all registered futures commission merchants ("FCMs") to become and remain members of at least one futures association registered under Section 17 of the Act. NFA is such a registered futures association and NFA Bylaw 1101 prohibits its members from transacting any customer business with persons who are not NFA members. Because only registered FCMs may carry customer accounts, a CTA entering orders for clients pursuant to a power of attorney must have such trades executed through a registered FCM. The combined effect of Commission Rule 170.15 and NFA Bylaw 1101 is to require CTAs managing client accounts to become NFA members. However, to the extent that a registered CTA is not managing customer accounts, it would appear that NFA membership is not required. See 48 Fed. Reg. 26304, 26306 n.22 (June 7, 1983).

Page 4

provide a Disclosure Document to clients pursuant to Rule 4.31.

This letter is based on the representations made in your letter, as supplemented. Any different, changed or omitted facts or circumstances might require us to reach a different conclusion. For example, in a telephone conversation with Division staff, you mentioned that your firm may set up a referral arrangement with various brokerage firms, whereby it may refer certain clients that attend its seminars to such firms for trading commodity interests, among other things. We note that such activity may bring your firm within the definition of an introducing broker ("IB"), thus requiring an additional registration for "X" as an IB. Therefore, please consult this office again should the operations or activities of "X" change in any way from those you have represented to us.

If you have any questions concerning this correspondence, please contact me or Monica S. Amparo, an attorney on my staff, at (202) 418-5450.

Very truly yours,

Susan C. Ervin
Chief Counsel