CFTC Letter No. 97-64

July 15, 1997

Division of Trading & Markets

Re: Rules 4.7, 4.31, and 4.33: Application of Commission Rules to Registered CTA Located Outside of the United States

Dear :

This is in response to your letter dated May 16, 1997 to the Commodity Futures Trading Commission (Commission), which has been referred to the Commission s Division of Trading and Markets (Division) for reply. By your letter, you explain that X , a registered commodity trading advisor (CTA), currently has as its sole client a European bank but that it intends to expand its client base to include institutional investment firms or qualified eligible clients in the USA. You then pose several questions relating to X s current and intended activities, which we repeat and answer below.

1. Trading takes place only for institutions and QEC s and only in non us [sic] markets, so what is meant by exempt for this clients from certain disclosure documents and recordkeeping requirements.

The sentence about which you inquire appears at page 31 of the CPO/CTA Regulatory Guide published by the National Futures Association (NFA), and states:

> CTAs that have QECs would be exempt from the requirement to prepare
> and distribute a Disclosure Document and certain recordkeeping
> requirements.

This sentence refers to the relief from disclosure and recordkeeping requirements of Rules 4.31 and 4.33, respectively, made available to qualifying CTAs by Commission Rule 4.7 (b). The Commission adopted Rule 4.7 in recognition of the fact that certain persons engaged in trading commodity interests are highly sophisticated and do not need the full protections provided by those requirements. Thus, Rule 4.7(b) permits a registered CTA to claim relief from the otherwise applicable disclosure and recordkeeping requirements with respect to certain highly sophisticated persons, or qualified eligible clients (QECs), as that term is defined in the rule.[1]

In order for a CTA to claim relief pursuant to Rule 4.7(b), it must be registered under the Commodity Exchange Act (Act), satisfy the requirements of Rule 4.7(b)(2) and file a notice of claim for exemption with the Division, which must contain certain information and representations. The notice is effective upon filing. We have enclosed a copy of Rule 4.7(b) for your information.

The fact that a registered CTA trades in commodity interests executed on a foreign board of trade does not affect the applicability to it of the Commission s disclosure and recordkeeping requirements for registered CTAs or the availability of the relief in Rule 4.7(b) from those requirements. We have enclosed copies of Rules 30.1 - 30.5, pertaining to foreign futures and options transactions, for your information.

2. Do I have to send out a disclosure document to institutionals?

Rule 4.31 provides that no CTA registered or required to be registered under the Act may solicit a prospective client, or enter into an agreement with a prospective client to direct the client s commodity interest account or to guide the client s commodity interest trading, unless the CTA has provided the client with a disclosure document containing specified information.[2] However, as noted above, Rule 4.7(b) makes available an exemption from the specific requirements of Rule 4.31 with regard to accounts owned by QECs.[3] Further, in certain instances, the Division has granted an exemption from the disclosure document requirement to CTAs whose only clients are non-U.S. persons. Copies of letters in which the Division has granted such relief are enclosed.

3. Does the CFTC/NFA need a current disclosure document for approval under this case?

If X is subject to Rule 4.31, unless X qualifies for, and files a notice of a claim for exemption pursuant to Rule 4.7(b), it must comply with the requirement in Rule 4.36 that it file with the Commission two copies of the disclosure document for each trading program that it offers or that it intends to offer not less than 21 calendar days prior to the date the trading advisor first intends to deliver the disclosure document to a prospective client. In addition, as an NFA member, X must comply with NFA Compliance Rule 2-13(c), which provides that each NFA member required to file any document with or give notice to the Commission under Commission Rules 4.7, 4.22, 4.26, or 4.36 must also file one copy of such document with or give such notice to NFA at its Chicago office no later than the date such document or notice is due to be filed with or given to the Commission.

4. Currently I trade my CTA trading programm only for a europe bank. All of the recordkeeping takes place in the bank s back office. For my performance calculation, the bank uses an auditor/ attorney at law who calculates the monthly performance. Every month, he sends me _only_ the approved and audited performance record for my files. All other files like equity run, trading sheet I have to send to the bank at every end of the month, so all files stay in the bank (cause they treat

me as external bank trader).

We understand this question to ask whether the current arrangement you have with the European bank satisfies Commission regulations relevant to recordkeeping. Rule 4.33 requires that a registered CTA maintain at its main business office the books and records specified in the rule. The Division has granted relief from the location requirement of Rule 4.33 where a CTA has demonstrated a need to maintain its records at a location other than its main business office. X may seek relief by making a written request to the Division for an exemption from the location requirement of Rule 4.33. The request should set forth the basis upon which X believes the Division should grant the requested relief.. We have enclosed a copy of a letter in which the Division granted relief from the books and records location requirement of Rule 4.33 for your information.

We trust that the foregoing information will be helpful. If you have any further questions, please feel free to contact me or Monica S. Amparo, an attorney on my staff, at (202) 418-5450.

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Very truly yours,

Susan C. Ervin

Chief Counsel

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[1] Similarly, Rule 4.7(a) permits a registered commodity pool operator (CPO) to claim relief from substantially all of the Part 4 disclosure, reporting and recordkeeping requirements that would otherwise be applicable to it, where all of the participants in its pool are qualified eligible participants (QEPs), as that term is defined in the rule. In general, Rule 4.7 contains similar definitions for QECs and QEPs, although this is not true with respect to non-United States (non-U.S.) persons. Rule 4.7(a) includes non-U.S. persons within the QEP definition but Rule 4.7(b) does not include non-U.S. persons within the QEC definition. Of course, a non-U.S. person may qualify as a QEC based upon the other definitional criteria of Rule 4.7(b).

[2] A directed account, as defined in Rule 4.10(f), is one in which a person is authorized to cause transactions to be effected for a client's commodity interest trading account without the client's specific authorization. A guided account, although not specifically defined in a rule, is characterized as one in which the CTA does not hold a power of attorney over the account, but nonetheless seeks to influence the trading in the client s account by recommending actual trades to the client and tailoring those recommendations to the client s investment needs. See CFTC Interpretative Letter 86-15, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,165 at 32,412 (July 22, 1986), a copy of which is enclosed.

[3] Whether an institutional is a QEC may be determined by comparing the investment, organizational and

other facts applicable to the QEC criteria of Rule 4.7(b).

Alternatively, if X is subject to Rule 4.31 and does not qualify for relief pursuant to Rule 4.7(b), it may file for consideration by the Division a written request for relief from Rule 4.31. The request should specify the basis upon which X believes the Division should grant relief from Rule 4.31. See note 2 above.