

CFTC Letter No. 02-02

December 20, 2001

Interpretation

Division of Trading and Markets

Re: Rules 4.24(l) and 4.34(k) - Request for exemption from requirement that a registered CPO/CTA disclose a material self-regulatory organization action involving the CPO/CTA and concluded within the past five years

Dear:

This is in response to your letter dated November 27, 2001, to the Division of Trading and Markets (the "Division") of the Commodity Futures Trading Commission (the "Commission"), as supplemented by telephone conversations with Division staff. By your correspondence, you request an exemption permitting you to omit from your Disclosure Document information regarding an action brought by (the "SRO") against yourself, "P" and "Q". The SRO action was resolved by a Decision dated _____, 1997, and absent the requested relief, you would be required to include information about it in your Disclosure Document until _____, 2002, or five years following the date of resolution.

Based upon the representations contained in your correspondence, we understand the facts to be as follows. You are the sole principal of "Q", which is registered with the Commission as an introducing broker ("IB"), a commodity pool operator ("CPO") and a commodity trading advisor ("CTA"). "Q" and you are the only principals of "P", which is registered as a CTA. You are registered as an associated person ("AP") of each of "Q" and "P".^[1] On _____, 1995, the SRO's Business Conduct Committee ("BCC") issued a complaint alleging that you, "Q" and "P" used promotional material that was misleading and deceptive and that included hypothetical trading results without accompanying those results with the required disclaimer, in violation of SRO Rules. On _____, 1995, you requested a hearing, and you heard nothing further from the SRO until you telephoned in July 1997, insisting on your request for a hearing date.

On _____, 1997, the SRO's BCC issued its Decision accepting the settlement offer submitted by you, "Q" and "P". The settlement offer neither admitted nor denied the allegations in the SRO's complaint. The BCC ordered you, "Q" and "P" to refrain from disseminating any promotional material to existing or prospective customers for a period of three years from the date of the Decision (until _____, 2000). The BCC further ordered you, "Q" and "P" to pay a \$10,000 fine.

On _____, 1999, the BCC modified the Decision to permit you to use promotional material if you submitted it to, and obtained the approval of, the SRO's Vice President of Compliance before disseminating such material.

Shortly prior to the issuance of the SRO complaint, the Commission had adopted amendments to its rules affecting the preparation and distribution of Disclosure Documents by CTAs and CPOs.^[2] At that time, Commission Rule 4.24(1) for CPOs and 4.34(k) for CTAs took their present form.^[3] Because we understand that the Disclosure Document you are concerned with is a CTA Disclosure Document, this discussion will focus on Rule 4.34.^[4] In relevant part, Rule 4.34(k) provides as follows:

§4.34 General disclosures required.

Except as otherwise provided herein, a Disclosure Document must include the following information:

* * * * *

(k) *Litigation.* Subject to the provisions of §4.34(k)(2), any material administrative, civil or criminal action, whether pending or concluded, within five years preceding the date of the Document, against any of the following persons; *Provided, however,* that a concluded action that resulted in an adjudication on the merits in favor of such person need not be disclosed:

(1) the commodity trading advisor and any principal thereof;^[5]

You contend that, but for the delay by the SRO in responding to your request for a hearing, the action brought against you and your companies would have been resolved at an earlier date, the five-year period during which Rule 4.34(k) requires disclosure of the SRO action would have run, and you would no longer be required to include that information in your Disclosure Document. The language of the rule ("any material administrative, civil or criminal action, whether pending or concluded, within five years preceding the date of the Document") is straightforward and does not examine whether an action was promptly concluded or drawn out for one reason or another. The fact that a \$10,000 fine was imposed together with a three-year ban on dissemination of promotional material indicates materiality, and the date of the Decision is less than five years prior to the date of your request. The only exception the rule makes to the disclosure requirement is an action concluded in the registrant's favor on the merits. Moreover, as you know, Rule 4.34(o) requires disclosure to existing or prospective clients of all material information "even if the information is not specifically required" by Rules 4.31, 4.34, 4.35 and 4.36.

Based upon the representations that you have made, the Division does not believe that it is appropriate to grant the requested exemption.^[6] Rule 4.12(a) permits the Commission to exempt any person from any provision of Part 4 of the Commission's rules upon a finding that the exemption is not contrary to the public interest and the purposes of the provisions from which the exemption is sought. Rule 140.93(a)(1) delegates to the Director of the Division the granting of exemptions under Rule 4.12(a). You have not made the required showing to support granting your request.

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

Very truly yours
John C. Lawton
Acting Director

[1] You are also an AP, the managing member and the sole principal of "T", a registered IB guaranteed by "U", but "T" was not involved in the SRO action and is not subject to the requirements from which you seek exemption.

[2] See Amendments to Commodity Pool Operator and Commodity Trading Advisor Disclosure Rules, 60 Fed. Reg. 38146 (July 25, 1995). The effective date of the amendments was August 24, 1995.

[3] Commission rules referred to herein are found at 17 C.F.R. Ch. I (2001).

[4] Rule 4.24(1) places virtually identical requirements on CPO Disclosure Documents.

[5] Prior to adoption of the 1995 amendments, if there were no actions against the persons listed in the rule in the prior five years, former Rule 4.31(a)(7) had required an affirmative statement to that effect.

[6] The Division is unaware of any prior instance in which a request such as yours has been granted.