

**CFTC letter No. 03-26**

**May 30, 2003**

**Interpretation**

**Division of Clearing and Intermediary Oversight**

Re: Section 4m -- Interpretation with regard to Commodity Trading Advisor Registration

Dear :

This is in response to your e-mail dated April 22, 2003, to the Division of Clearing and Intermediary Oversight (the "Division"), as well as conversations with Division staff. By your correspondence, you ask for confirmation that you will not be required to register as a commodity trading advisor ("CTA") with regard to the solicitation of clients for a trading program that you have developed.

We understand the facts to be as follows. You are a registered associated person ("AP") employed by .X., a registered introducing broker ("IB"). You have created a trading program that generates trading signals. You intend to solicit clients to utilize your trading program. Such clients will execute a "letter of direction" providing that .X. should execute trades for the clients' accounts and "follow [the trading program] signals as close as reasonably possible." You have indicated that you will not receive any incentive or management fees with regard to clients that use your trading program, but you will instead receive per-trade commissions as an AP of .X., for clients that utilize your trading program. .A., Director of Compliance for .Y., a principal of .X. and the FCM by which .X. is guaranteed, also represented these to be the facts with regard to the business activities of .X. and yourself.<sup>[1]</sup> .A. also indicated that your activities as an AP of .X. would consist solely of soliciting clients for your trading program.

A CTA is defined as any person who, for compensation or profit, advises others as to the value or advisability of trading in any futures contracts or commodity option.<sup>[2]</sup> Generally, absent an exemption, a person falling within the definition of CTA is required to be registered with the Commission as such.<sup>[3]</sup>

In March 2000, the Commission adopted Rule 4.14(a)(9), exempting from mandatory registration under the Act CTAs whose business is limited to distributing standardized commodity trading advice.<sup>[4]</sup> Thus, Rule 4.14(a)(9) exempts from registration CTAs who do not provide trading advice based on, or tailored to, the commodity interest or cash market positions or other circumstances or characteristics of particular clients. In order to qualify for the exemption under Rule 4.14(a)(9), a CTA may not tailor to a client's particular circumstances any opinion given as to what commodity interests to buy or sell. Additionally, Rule 4.14(a)(9) exempts from registration CTAs who do not direct client accounts, meaning that it may not be authorized to cause transactions to be effected for any client's commodity interest account.

In adopting Rule 4.14(a)(9), the Commission noted it intended "that a CTA who manages a client's

trading under some type of informal arrangement be required to register even if the CTA is not authorized to effect transactions without the client's specific authorization."<sup>[5]</sup> The Commission further stated that the language of Rule 4.14(a)(9)(ii) "cover[s] CTAs that informally manage their customer's trading"<sup>[6]</sup> and, therefore, such arrangements would require the CTA to register with the Commission.

The Commission presented examples in the rule release of fact patterns in which the exemption provided for in Rule 4.14(a)(9) would be applicable. While these examples most specifically dealt with the issue of whether the CTA's advice was based on or tailored to the particular circumstances of the client, it is worth noting that in the examples in which the exemption provided for in Rule 4.14(a)(9) was applicable the client's connection with the CTA did not include the establishment of a trading account with the CTA or a firm with which the CTA was associated.

It is the Division's opinion that, as the clients' contact with the CTA includes not only the trading program, but also the opening of a trading account that is traded pursuant to a "letter of direction," the facts as represented by you, and confirmed by .A., would indicate the presence of the type of "informal arrangement" for which the exemption provided under Rule 4.14(a)(9) was not intended. Moreover, the fact that the whole of your activities as an AP of .X. consists of the solicitation of clients for the trading program would urge registration as a CTA. Accordingly, registration as a CTA is required of either .X. or yourself.<sup>[7]</sup>

The Division notes that, regardless of whether you or .X. register as a CTA, pursuant to Rule 166.3, .X. is under a duty to diligently supervise your activities as it relates to .X's. business as a Commission registrant. As you are to be compensated on a per-trade basis, in addition to the supervisory duties generally exercised by .X. with regard to its employees, .X's. duty to supervise your activities includes, but is not limited to, reviewing the accounts traded pursuant to your trading program to ensure that there is not any "churning" of accounts.

The opinions expressed in this letter are based upon the representations you have made to the Division. Any different, changed, or omitted facts or conditions might render this opinion void. Moreover, this letter represents the opinions of the Division only and does not necessarily reflect the views of the Commission or any other office or division of the Commission. If you have any questions concerning this correspondence, please contact Michael A. Piracci, an attorney on my staff, at (646) 746-9704.

Very truly yours,

Jane Kang Thorpe  
Director

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<sup>[1]</sup> In discussions with Division staff, you asked that .A. be permitted to contact Division staff with

regard to your request.

[2] Section 1a(6) of the Commodity Exchange Act (the "Act"). *See also* Commission Rule 1.3(bb). Commission rules referred to herein may be found at 17 C.F.R. Ch. 1 (2002).

[3] *See* Section 4m(1) of the Act.

[4] 65 Fed. Reg. 12938 (Mar. 10, 2000). A copy of the *Federal Register* release may be viewed on the Commission's web site at: <http://www.cftc.gov/files/foia/fedreg00/foi000310a.pdf>.

[5] *See* 65 Fed. Reg. at 12941.

[6] *Id.*

[7] If .X. registers as a CTA, as a registered AP of .X., you would not also be required to register as a CTA in your individual capacity.