93-11

**COMMODITY FUTURES TRADING COMMISSION**
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(202) 254 - 8955
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DIVISION OF
TRADING AND MARKETS

February 10, 1993

Re: CTA Recordkeeping Requirements

Dear :

This is in response to your letter to the Division of Trading and Markets (the "Division") dated April 7, 1992, as supplemented by telephone conversations with Division staff, in which you request regulatory relief on behalf of certain commodity trading advisors ("Recommended CTAs") which direct accounts for clients of , ("Company"), an investment adviser registered as such with the Securities and Exchange Commission and itself a registered commodity trading advisor ("CTA").

Based upon the representations made in your letter, as supplemented, we understand the facts to be as follows. Company is an investment adviser and CTA to certain clients who authorize Company to act as their agent and attorney-in-fact with respect to the management of certain of their assets and, in particular, with respect to the retention and termination of Recommended CTAs which are selected to direct the commodity interest trading of clients' commodity interest trading accounts.

Company is authorized to direct the actual trading of clients' accounts. Clients also grant Company the power to enter into agreements with Recommended CTAs on their behalf. However, Company may retain a Recommended CTA only after consultation with, and subject to the approval of, the particular client. Company therefore is acting as a "Recommending CTA".[1/] Due to sensitive business reasons, one client ("Client") has specifically expressed its desire that it not be identified to Recommended CTAs selected by Company. Client is a qualified eligible client ("QEC") as that term is defined in Commission

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1/ See CFTC Interpretative Letter 90-16, Comm. Fut. L. Rep. (CCH) [Current Transfer Binder] ¶ 24,918 (August 21, 1990).

Rule 4.7(b)(1)(ii).[2] With respect to the Client, Company receives from the Recommended CTA, and delivers to the Client, a copy of the Recommended CTA's Disclosure Document, receipt of which in turn is acknowledged by the Client in writing to Company. The written acknowledgment of receipt is then retained by Company in its files. Company itself signs an identical acknowledgment of receipt of the Disclosure Document and returns this acknowledgment to the Recommended CTA. Both acknowledgments are executed and returned to Company or the Recommended CTA, as the case may be, within the timeframe specified by Commission Rule 4.31.[3] The Client currently has one account at one futures commission merchant ("FCM"), with one subaccount for each Recommended CTA.

In your letter to the Division you requested, on behalf of all Recommended CTAs retained by Company on behalf of Client, relief from certain of the applicable recordkeeping requirements set forth in Rule 4.32(a). This rule generally requires every CTA registered or required to be registered under the Commodity Exchange Act[4] to keep in an accurate, current and orderly manner at its main business office certain records, discussed more fully below.

In support of your request you explained that the FCM who carries the account of the Client has on file two powers of attorney: the first is from the Client in favor of Company; the second is from Company in favor of the Recommended CTA. Therefore, the FCM understands that the Recommended CTA is the CTA directing trading for the account. You have advised us that the Client itself signed account opening documentation at the

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2/ 57 Fed. Reg. 34853 (August 7, 1992; effective September 8, 1992). Rule 4.7(b)(1)(ii) defines QEC to include certain highly accredited investors that meet a certain portfolio requirement. Other Commission rules referred to herein are found at 17 C.F.R. Ch. I (1992).

3/ You have stated that Company will make available upon request to the Commission and other regulatory bodies the signed acknowledgments of receipt of the Disclosure Documents of all Recommended CTAs with whom Company maintains a relationship on behalf of the Client, as well as the name and address of the Client. You request, however, that this information not be disclosed to the Recommended CTAs involved, because the Client has advised you that it wishes to keep its commodity interest trading activity confidential.

4/ 7 U.S.C. § 1 et seq. (1988), as amended by the Futures Trading Practices Act of 1992, Pub. L. No. 102-546, 106 Stat. 3590.

FCM, including the acknowledgment of the risk disclosure statement required by Rule 1.55. However, monthly and confirmation statements and purchase and sale statements delivered by the FCM to Company and the Recommended CTA as required by Rules 1.33(a), (b) and (d) and Rule 1.46 do not refer to the Client by name as the owner of the account. Rather, they refer to the Client only by Company's name and by the account number that the FCM has assigned to the account. If a Recommended CTA were to have more than one Company account, it would be able to distinguish them by account number. Company would also be able to distinguish them by account number. The FCM also delivers monthly and confirmation statements and purchase and sale statements to the Client.[5/]

Commission Rule 4.32 requires CTAs to keep certain records with respect to their clients. Certain of these rules both presume and require knowledge on part of the CTA of the identity of its clients. For example, Rule 4.32(a)(1) requires the CTA to keep a record of the name and address of each client.

As noted above, you represent that the Client is a QEC. As you are aware, Commission Rule 4.7(b)(2) provides in relevant part that subject to certain conditions and the filing of a notice with the Commission,

> any registered commodity trading advisor who anticipates directing or guiding the commodity interest accounts of qualified eligible clients will be exempt as follows with respect to the accounts of qualified eligible clients who have given due consent to their account being an exempt account under Rule 4.7 . . .
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> (ii) Recordkeeping. Exemption from the specific requirements of § 4.32; Provided, That the commodity trading advisor must maintain, at its main business office, all books and records prepared in connection with his activities as the commodity trading advisor of the qualified eligible clients (including, without limitation, records relating to the qualifications of such qualified eligible clients and substantiating any performance representations) and must make such records available to [certain government officials].

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5/ The versions of these documents delivered by the FCM to the Client itself do contain the Client's name. Copies of the rules referred to in this paragraph are enclosed.

You have also represented that the Client is willing to give its "due consent", as required by Rule 4.7(b)(2), to its accounts being exempt accounts under Rule 4.7. Therefore, Recommended CTAs may be able to claim exemption from the specific recordkeeping requirements of Rule 4.32 noted above with respect to the Client, provided that the Recommended CTAs observe the conditions to the exemption set forth in Rule 4.7(b). One of these conditions, quoted above, would require the Recommended CTA to maintain, at its main business office, records relating to the qualifications of the QEC.

To preserve the confidentiality desired by the Client, you contemplate that Company will obtain (and has in fact obtained) representations from the Client which enable Company to conclude that the Client is a QEC, and that Company will provide the Recommended CTA with written representations that it has obtained representations sufficient for it to conclude that the Client is a QEC and that the Client has consented to treatment of the account as an exempt account under Rule 4.7. Under these circumstances, the Recommended CTAs, if relying in good faith upon Company's representations and any other information available to them, would be able to claim relief under Rule 4.7 from the specific requirements of Rule 4.32, compliance with which would generally require a CTA to have knowledge of its client's name and address. Whether such conclusions are reasonable in any given situation would depend on all the facts and circumstances, and is a determination that must be made by the Recommended CTA before claiming relief under Rule 4.7.[6/]

The Division notes that Rule 4.7(b)(3)(i)(H) provides that the notice of claim for exemption shall

> [b]e received by the Commission before the date the commodity trading advisor first enters into an agreement to direct or guide the commodity interest account of a qualified eligible client pursuant to § 4.7.[7/]

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6/ Although Rule 4.7 provides an exemption from the specific requirements of Rule 4.32, absent the presence of a Recommending CTA as described herein, a CTA would generally be expected to know a client's name and address in connection with making a good-faith determination that the client is a QEC.

7/ You should also be aware that other provisions of Rule 4.7 governing the use by CTAs of the exemptions provided for therein contain relevant conditions to and limitations on the use of the exemptions, and should be reviewed carefully.

Based upon your representations, the Division will not recommend that the Commission take any enforcement action against any Recommended CTAs claiming relief with respect to the Client's account under Rule 4.7 as discussed above solely for their failure to comply with the Rule 4.7(b)(3) condition as to timing, provided that the Recommended CTA file the notice with the Commission within 60 days of the date of this letter.

Additionally, you expect that certain of Company's future clients will express a similar desire to not be identified to Recommended CTAs (collectively, the "Future Clients"). You requested that any regulatory relief extended with respect to Client also be given with respect to Future Clients whose circumstances are identical to those of the Client described above. The Division expects that Recommended CTAs will be able to rely on Rule 4.7(b)(2)(ii) for any Future Client who is a QEC, who specifically requests that its identity not be disclosed to Recommended CTAs and who consents to its account being an exempt account under Rule 4.7(b), provided that the Recommended CTA obtains written representations from Company comparable to those discussed above with respect to the Client and complies with all other conditions to relief set forth in the rule, and provided that the Future Client's identity is disclosed to the FCM(s) carrying the managed account(s).[8/]

The Client and any Future Clients should be aware that, with certain exceptions, Rule 1.46 provides that an FCM must, on the same day, apply a customer's purchase or sale against that customer's previously held short or long position, as the case may be, in the same future of the same commodity on the same market. Thus, where a Recommended CTA trades an account not knowing the identity of the account owner pursuant to one program and trades another account belonging to the same customer pursuant to a different program, opposite positions in the two accounts, if carried at the same FCM, may be closed out by the FCM pursuant to Rule 1.46 even though the Recommended CTA did not intend this result. It also appears that the above arrangements should not affect compliance with the Commission's rules on position limits, provided that controls are in place to assure that the Client or Future Client is aware of the positions of each and every Recommended CTA trading on its behalf, or on large trader reporting requirements.

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8/ Rule 1.37 requires each FCM to keep a record in permanent form showing for each commodity futures or option account it carries the true name and address of the person for whom the account is carried. This requirement remains fully applicable to each FCM carrying a Client or Future Client account.

The views expressed in this letter are based upon the representations that have been made to us and are subject to strict compliance with those representations and the above conditions, and are applicable solely with respect to the Client and Future Clients referred to herein. Any different, changed or omitted facts or conditions might require us to reach a different conclusion. In this connection, we request that you notify us immediately in the event that Company's operations change in any way from those as represented to us. Further, this letter represents the position of the Division of Trading and Markets only. It does not necessarily represent the views of the Commission or of any other office or division of the Commission.

We note that this letter does not excuse Company or any Recommended CTA from compliance with any other applicable requirements contained in the Commodity Exchange Act or in the Commission's regulations thereunder. For example, they each remain subject to the antifraud provisions of Section 4o of the Commodity Exchange Act, and to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the regulations. This action does not constitute a waiver of or otherwise affect the Commission's authority under Section 6(c) of the Commodity Exchange Act to "require the production of any books, papers, correspondence, memoranda or other records that the Commission deems relevant or material to [an] inquiry" as the Division, of course, has no authority to limit the Commission's statutory jurisdiction in this regard. Further, the Division does not intend to limit in any way the authority of the National Futures Association to require production of records pursuant to its rules. Finally, we note that this letter does not preclude the Commission from taking action against the Recommended CTAs for past violations of Rule 4.32, if the Commission determines that such action is appropriate.

If you have any questions concerning this matter please call me or Carla Behnfeldt, an attorney on my staff, at (202) 254-8955.

Very truly yours,

Susan C. Ervin
Chief Counsel

Enclosures
CJB:cjb