COMMODITY FUTURES TRADING COMMISSION
2033 K Street, NW, Washington, DC 20581
(202) 254 - 8955
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95-87

DIVISION OF
TRADING AND MARKETS

September 19, 1995

Re: Section 4m(1): Request for Opinion on Whether Activities of Derivatives Department Require Registration as Commodity Trading Advisor

Dear :

This is in response to your letter dated May 3, 1995 to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission") in which you request the Division's opinion as to whether the activities of the "X" Derivatives Department ("Department") would require "X" to register as a commodity trading advisor ("CTA"). Commission records indicate that "X" currently is registered with the Commission as a futures commission merchant ("FCM").

Based upon the representations made in your letter, we understand the pertinent facts to be as follows. Its primary function is to aid "X's" Corporate and Public Finance investment bankers in obtaining transactions that "X" can underwrite as either lead manager or co-manager.[1/] In this regard, the Department will both respond to questions from and prepare presentations for clients and potential clients concerning specific transactions and or structures that utilize derivatives. The Department's presentations to clients help explain "X's" role in the transaction (e.g., it will act as agent not principal) and the structure of the derivatives instruments (e.g., what interest rate swaps are and how they operate). "X" does not value any derivatives transactions.

Section 4m(1) of Commodity Exchange Act (the "Act")[2/] prohibits a person from using the mails or any means or instrumentality of interstate commerce in connection with his

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1/ You represent that the derivatives products that "X" and the Department discusses and/or proposes to clients are most often of the "plain vanilla" type.

2/ 7 U.S.C. § 6m(1) (1994).

business as a CTA, unless registered under the Act. As defined in Section 1a(5) of the Act,[3] a CTA is --

> any person who, for compensation or profit, engages in the business of advising others, either directly or through publications, writings or electronic media, as to the value of or the advisability of trading in any contract of sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market, any [authorized] commodity option or any [authorized] leverage transaction or who, for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the foregoing . . . .[4]

Persons who engage in activities of the nature set forth in Section 1a(5) of the Act must register as a CTA unless an exemption under the Act or Commission regulations is available to them.

To determine whether an exemption is applicable, it is necessary to review each derivative transaction or type of transaction for which "X" provides advisory services against the criteria set out in the relevant exemptions.[5] For example, Part 35 of the Commission's regulations exempts certain types of

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3/ 7 U.S.C. § 1a(5) (1994).

4/ The Act excludes from the definition of a CTA an FCM whose commodity interest advice is rendered in a manner that is solely incidental to the conduct of its business as an FCM. See Section 1a(5)(B) and (C) of the Act, 7 U.S.C. § 1a(5)(B)-(C) (1994). However, it does not appear that the advisory activities of the Department are undertaken in a manner solely incidental to its business as an FCM. For example, while there may be some overlap between the clients for whom "X" performs services as an FCM and the clients to whom the "X" will make proposals and presentations on derivatives transactions, the clients of "X's" FCM operations and those of the Department are generally different. Moreover, the Department's "primary function is to assist [the] Corporate and Public Finance investment bankers [in] obtain[ing] transactions that ["X"] can underwrite as either a lead manager or co-manager." Such activities do not appear to support "X's" business as an FCM.

5/ In this respect, it is not necessary that a client actually enter into the derivatives contract or agreement based on advice given for the definition of a CTA to apply to the advisor. It is the act of giving advice on a potential trade, and not any subsequent trade, that would render the statutory CTA definition applicable.

swap transactions and persons providing advice with respect to such products from most provisions of the Act and the Commission's rules, provided certain criteria are met.[6/] Similarly, certain hybrid instruments meeting the criteria set out in Part 34 of the Commission's rules[7/] are exempted from all provisions of the Act, except for Section 2(a)(1)(B) of the Act, and the Commission's regulations, as are persons offering advice on such instruments. Thus, based upon the facts provided to us, we are unable to evaluate whether "X" must register as a CTA. In this regard, "X" may wish to review with counsel the specific activities of the Department and each transaction to which these activities relate to determine first, whether these activities would implicate the statutory definition of CTA, and if so, whether "X" would be exempt from registration under relevant sections of the Act or Commission rules.

If you have any questions concerning this correspondence, please contact me or Thomas E. Joseph, an attorney on my staff. Effective September 25, 1995, you can contact us at our new office location by telephone, at (202)418-5430, or by facsimile, at (202)418-5536. Our new address is: Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581. The telephone and facsimile numbers printed at the beginning of this letter will be operational through September 22, 1995.

Very truly yours,

Susan C. Ervin
Chief Counsel

6/ 17 C.F.R. Part 35 (1995). Note that swap transactions meeting the criteria of Part 35 are not exempt from: (1) the antifraud provisions of Sections 4b and 4o of the Act, 7 U.S.C. §§ 6b and 6o (1994), and Commission Rule 32.9, 17 C.F.R. § 32.9 (1995); (2) Sections 6(c) and 9(a)(2) of the Act, 7 U.S.C. §§ 9 and 13(a)(2), to the extent that these provisions prohibit the manipulation of the market price of any commodity in interstate commerce or for future delivery on or subject to the rules of any contract market; and (3) Section 2(a)(1)(B) of the Act, 7 U.S.C. § 2a (1994).

7/ 17 C.F.R. Part 34 (1995).