



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Swap Dealer and
Intermediary Oversight

Matthew B. Kulkin
Director

CFTC Letter No. 17-65
Interpretation
December 11, 2017
Division of Swap Dealer and Intermediary Oversight

Ms. Allison Lurton
Futures Industry Association
2001 Pennsylvania Avenue, NW
Suite 600
Washington, DC 20006

Re: Staff Interpretation Regarding Commodity Trading Advisor Registration Requirements

Dear Ms. Lurton:

This is in response to your letter, dated November 30, 2017, to the Division of Swap Dealer and Intermediary Oversight (the “Division”) of the Commodity Futures Trading Commission (the “Commission” or the “CFTC”). You submitted your letter on behalf of your member futures commission merchants (“FCMs”), swap dealers (“SDs”), and introducing brokers (“IBs”). By your letter, you request that the Division issue an interpretation that an FCM or SD that offers commodity trading advice that is “solely incidental” to the conduct of its business or profession as an FCM or SD, or an IB that issues commodity trading advice that is “solely in connection with” its business as an IB, is not required to register as a commodity trading advisor (a “CTA”) under section 4m(1) of the Commodity Exchange Act (the “Act”) if such FCM, SD or IB receives separate payments from investment managers for such commodity trading advice.¹

Background

¹ For an FCM or IB, the interpretation provided herein would apply to their Associated Persons (“APs”) who are performing duties within the scope of their employment as APs of such FCM or IB. Although there is no AP registration category for SDs, this interpretation would apply to employees of the SD who are performing the duties traditionally associated with an AP, when such employees are acting within the scope of their duties as employees of the SD.

You state that your member FCMs, SDs and IBs engage in business with investment management firms that are subject to the laws of the European Union (hereinafter referred to as “EU Investment Managers”). Your member FCMs, SDs and IBs may provide commodity trading advice to these EU Investment Managers. The EU Investment Managers may pay your members for such commodity trading advice as part of a bundled payment or commission fee that combines investment research services and execution services. Your member FCMs, SDs and IBs that currently provide commodity trading advice to these EU Investment Managers are not required to register as CTAs provided that the commodity trading advice is “solely incidental” to the conduct of their respective businesses as an FCM or SD, or that the commodity trading advice is “solely in connection with” their respective businesses as an IB.²

You state that the EU Investment Managers will be required by the Markets in Financial Instruments Directive II (“MiFID II”) to unbundle payments for investment research (including commodity trading advice) from payments for execution services effective January 3, 2018.³ Accordingly, your members will no longer be able to collect a single, bundled fee for investment research services (including commodity trading advice) and execution services from EU Investment Managers. The separate investment research fees will be paid either from the EU Investment Managers’ own funds or through client funds that are specifically set aside in Research Payment Accounts (“RPAs”). You state that MiFID II requirements may have impacts that extend beyond EU Investment Managers. For example, investment managers that have global operations may elect to implement uniform payment protocols that comply with the MiFID II directive for investment research in EU and non-EU jurisdictions in lieu of developing controls for differing payment protocols in different jurisdictions.⁴

You state that your members are concerned that receiving a separate payment from an investment manager, including an EU Investment Manager, to purchase investment research services, which may include commodity trading advice, either through a direct hard dollar payment or an RPA mechanism, could result in the FCM, SD, or IB being deemed by Division staff to be acting as a CTA even if the commodity trading advice is “solely incidental” to the FCM’s or SD’s conduct of its business as an FCM or SD, or the commodity trading advice is “solely in connection with” the IB’s business as an IB.

Accordingly, you request an interpretation from the Division that an FCM, SD, or IB will not be deemed to be a CTA, or alternatively, will not be subject to registration as a CTA, if such FCM, SD, or IB receives separate payment for investment research services provided to

² You state that the requested interpretation would not apply to an FCM, SD or IB that otherwise receives separate compensation for commodity trading advice that is not solely incidental to, or solely in connection with, its business.

³ See, Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

⁴ Although this interpretation was requested on behalf of CFTC registrants who will be required to charge their European clients a separate unbundled fee for advisory services to comply with the MiFID II directive, this interpretation is not limited to entities who are bound by the MiFID II directive.

investment managers, which services are solely incidental to the FCM's or SD's conduct of its business, or solely in connection with its IB's business.

You state that the requested interpretation does not seek to redefine the term "commodity trading advisor" and would largely preserve the market's status quo. You further state that the request would provide clarity to parties whose research and advisory services would otherwise be considered "solely incidental" to, or "solely in connection" with, their trade or business, but for the receipt of separate compensation.

Current Regulatory Framework

Section 1a(12) of the Act broadly defines a CTA as any person who, for compensation or profit, directly or indirectly advises others as to the value or advisability of trading in futures, options or swaps, or regularly issues or promulgates analyses or reports concerning such derivative instruments. Section 1a(12) of the Act also excludes an FCM from the CTA definition if the FCM's commodity trading advice is "solely incidental" to the conduct of its business as an FCM. Similarly, Commission regulation 4.6(a)(3) excludes a registered SD from the CTA definition if the SD's commodity trading advice is "solely incidental" to the conduct of its business as an SD. Furthermore, Commission regulation 4.14(a)(6) exempts a registered IB from registering as a CTA if the IB's commodity trading advice is "solely in connection with" its business as an IB.

The Commission has not provided guidance regarding the extent of the commodity trading advice that an FCM or SD can provide to clients and remain within the CTA exclusions of section 1a(12) of the Act or regulation 4.6(a)(3), respectively. Similarly, the Commission has not provided guidance regarding the extent of the commodity trading advice an IB can provide to clients and remain within the CTA registration exemption of regulation 4.14(a)(6). The Commission, however, discussed certain activities that would be beyond the scope of the "solely incidental" limitation in its SD external business conduct standards rulemaking.⁵ In that preamble, the Commission stated that

[t]here are advisory activities that the Commission would consider to be beyond the scope of the "solely incidental" exclusion, and depending on the facts and circumstances could cause a swap dealer to be a CTA within the statutory definition. For example, a swap dealer that has general discretion to trade the account of, or otherwise act for or on behalf of, a counterparty would be engaging in activity that is not solely incidental to the business of a swap dealer. Limited discretion related to the execution of a particular counterparty order, however, would not cause a swap dealer to be a CTA. Also, the exclusion would not apply if a swap dealer received separate compensation for, or otherwise profited primarily from, advice provided to a counterparty. Furthermore, a swap dealer

⁵ See, Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 77 Fed Reg. 9734 at 9740 (February 12, 2012).

that enters into an agreement with its counterparty to provide advisory services or a swap dealer that otherwise holds itself out to the public as a CTA would also not be within the “solely incidental” exclusion. These examples are not exhaustive. There may be other circumstances in which a swap dealer’s activity would fall outside the available exclusion. A determination of whether activity is “solely incidental” would necessarily need to be viewed in context based on the particular facts and circumstances.⁶

The Division does not believe that the Commission intended to imply that commodity trading advisory activities that are “solely incidental” to the conduct of the SD’s business as an SD would no longer qualify for the exemption under Commission regulation 4.6(a)(3) solely because the SD received separate compensation for such services. The receipt of a separate payment for commodity trading advisory services is merely a factor to be considered among the facts and circumstances related to the advisory activities provided in determining whether the activities are indeed “solely incidental” to the conduct of a SD’s business as a SD, or whether the advisory activities are a separate, independent line of business more commonly associated with the business of a CTA.

Interpretation

Based upon the foregoing, the Division does not believe that an FCM, SD, or IB would be in violation of section 4m(l) of the Act for failing to register as a CTA in connection with the provision of commodity trading advice for separate compensation so long as the providing of the commodity trading advice is “solely incidental” to the conduct of its business as an FCM or SD, or “solely in connection with” its business as an IB. The analysis of whether the commodity trading advice is “solely incidental” to the FCM’s or SD’s conduct of its business, or “solely in connection with” the IB’s business must be performed by the FCM, SD or IB based upon the particular facts and circumstances of the relationship between the parties. Although direct payment for commodity trading advice may be one factor, receipt of separate compensation would not be dispositive on its own.

The interpretation provided herein represents the position of this Division only and does not necessarily reflect the views of the Commission or any other division or office of the Commission. This letter does not excuse persons relying on it from compliance with any other applicable requirements contained in the Act or in the Commission regulations issued thereunder. Further, this letter is based upon the representations made to the Division. Any different, changed or omitted material facts or circumstances might render this letter void. Finally, the Division retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the interpretation provided herein, in its discretion.

⁶ Id.

Ms. Allison Lurton
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Should you have any questions, please do not hesitate to contact Amanda Olear, Associate Director, at 202-418-5283, or Peter Sanchez, Special Counsel, at 202-418-5237.

Very truly yours,

Matthew B. Kulkin
Director
Division of Swap Dealer and
Intermediary Oversight

cc: Regina Thoele, Compliance
National Futures Association, Chicago