85-21

COMMODITY FUTURES TRADING COMMISSION
2033 K STREET, N.W., WASHINGTON, D.C. 20581

DIVISION OF
TRADING AND MARKETS

November 8, 1985

Dear :

This is in response to your letter dated September 4, 1985, whereby you requested on behalf of your client, the Company, that the Division not recommend that the Commission take any enforcement action against the Company if it fails to register as a commodity trading advisor ("CTA") in connection with providing advice to the Fund, a registered investment company formed by the Company, which has filed a notice of eligibility for exclusion from the definition of the term "commodity pool operator" ("CPO") pursuant to Rule 4.5, 50 Fed. Reg. 15868 (April 23, 1985).

Based upon the representations you made in your letter, we understand the facts to be as follows:

> The Fund's investment strategy will primarily involve investments in U.S. Government securities, including U.S. Treasury securities and certain mortgage-backed securities. It is a fundamental policy of the Fund that at least 65% of its total assets will be invested in U.S. Government securities and it is expected that under normal market conditions at least 80% of the Fund's total assets will be invested in U.S. Government securities. The Fund's proposed transactions in the commodity futures and options markets, . . . will be collateral to its investments in U.S. Government securities. . . . 1/
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> The Company, a registered investment adviser ["IA"] and one of the nation's largest financial institutions, provides a broad range of financial products and services through a nationwide distribution network. The Company, and its subsidiaries and affiliates, currently manage assets of approximately $24 billion. The Company will select and review the Fund's investments, and employees of the Company will make the

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1/ In this regard, the notice of eligibility filed by the Fund contained the representations on operating criteria specified by Rule 4.5(c)(2).

> actual trading decisions for the Fund. The Fund will pay the Company a monthly fee for these advisory services based upon the net assets of the Fund under management. . . . An affiliate of the Company which is a registered broker-dealer will solicit investments in the Fund through its network of registered representatives.

Based upon the foregoing facts, you concluded, and we agree, that if the Company directs the Fund's trading in commodity interests, it will come within the definition of the term "commodity trading advisor" set forth in Section 2(a)(1)(A) of the Commodity Exchange Act (the "Act"), 7 U.S.C. §2 (1982). 2/ In support of the requested "no-action" position, however, you argued, among other things, that in the instant situation the Company comes within the spirit, if not the letter, of Rule 4.14(a)(5), 17 C.F.R. §4.14(a)(5) (1985). That rule provides exemption from registration as a CTA for any person who is exempt from registration as a CPO and whose trading advice is directed solely to, and for the sole use of, the pool or pools for which it is so exempt. In furtherance of that argument, in our telephone conversation you noted that two of the six members of the Fund's Board of Directors hold senior positions with the Company. 3/ Moreover, in a telephone conversation with Division staff, your associate explained that

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2/ Section 2(a)(1)(A) provides in pertinent part that a CTA is --

> [A]ny person who, for compensation or profit, engages in the business of advising others . . . as to the value of or the advisability of trading in [commodity interests]. . . .

You further have represented that the Company provides advice on commodity interest trading to a wholly-owned subsidiary of the Company, for use in connection with the management of its general account. We similarly agree with your conclusion that the Company should not be viewed as a CTA for those purposes. This is because, in that situation, the Company in effect is providing advice to itself -- and not to "others" as contemplated by the statutory definition. Cf. Rules 4.5(a)(2) and (b)(2), which makes an exclusion from the CPO definition available for State-regulated insurance companies in connection with their operation of certain separate accounts.

3/ Those members are "A" and "B", who respectively hold the positions of Senior Vice President Investments and Executive Vice President - Finance with the Company.

those two members are the senior personnel who will supervise those of the Company's employees who will be involved in commodity interest trading. 4/

You also made the argument that:

> The objectives which prompted the Commission to adopt Rule 4.5 [-- i.e., avoidance of duplicative regulation] provide a persuasive basis for the Division to take a no-action position with respect to registration as a commodity trading advisor by the Company. The Company is also subject to extensive regulation under ongoing regulatory schemes, both as an insurance company and as a registered investment adviser. The Company will furnish hedging advice to a single registered investment company which itself qualifies for exclusion under Rule 4.5. Thus, the nature and extent of the Company's commodity trading advisory activities is limited and these activities are merely one aspect of the broad range of financial services and products offered by the Company and its subsidiaries and affiliates. [Emphasis added.] 5/

The Division notes that rule 4.14(a)(5) applies solely to persons who are exempt from registration as a CPO. Rule 4.14(a)(5) thus does not expressly apply to persons who are excluded from the definition of CPO by rule 4.5 or to persons whose non-CPO status is premised upon the fact that the entities under their control are excluded from the definition of "pool"

4/ Specifically, your associate explained that "A" and "B" will have the ultimate supervisory responsibility over "C", who will be responsible for developing the overall strategies to be employed in connection with directing the Fund's commodity interest trading. "C", in turn, will supervise those employees responsible for the implementation and timing of those strategies.

5/ Cf. 49 Fed. Reg. 4778 at 4785 (February 8, 1984), wherein the Commission indicated that it --

> is considering adopting a rule that would exempt from registration as a CTA a person who is registered as an IA and who was formed for the sole purpose of and whose sole business is to provide investment advice to a person and an entity who have qualified for exemption under proposed §4.5. [Emphasis added.]

To date, the Commission has not taken any action on that proposal. See 50 Fed. Reg. 15868 at 15869.

under rule 4.5(a)(4). Clearly, the mere fact that an entity is not a commodity pool does not mean that its adviser is not a CTA.

Nonetheless, rule 4.14(a)(5) does reflect a general Commission intent to eliminate any unnecessary costs and burdens of regulation. 6/ Consistent with that intent, the Division believes that adoption of a no-action position with respect to a person's CTA registration would be appropriate under other circumstances not specified in rule 4.14(a) where the costs and burdens of CTA registration would appear to outweigh any regulatory benefit -- e.g., in the instant situation. Furthermore, adoption of such a position in this situation would be consistent with the general policy of rule 4.5, which essentially reflects a Congressional and Commission intent to avoid, where appropriate, unnecessary and duplicative CPO regulation for certain "otherwise regulated" persons. 7/

Accordingly, based upon the foregoing, the Division will not recommend that the Commission take any enforcement action against the Company if it fails to register as a CTA in connection with providing advice on commodity interest trading to the Fund. This position is, however, subject to compliance with the following two conditions: (1) upon the request of a duly authorized Commission representative, the Company must provide access to the books and records it keeps and maintains in connection with directing the

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6/ The practical effect of rule 4.14(a)(5) is to exempt from CTA registration persons who operate and advise essentially family, club and small, unsolicited commodity pools, as specified in rule 4.13, 17 C.F.R. §4.13 (1985). Cf. 44 Fed. Reg. 1918 at 1919 (January 8, 1979), wherein the Commission stated that those exemptions were adopted because "the costs of compliance with the Part 4 rules outweigh the benefits to be gained from regulating family, club and small pools."

7/ S. Rep. No. 384, 97th Cong., 2d Sess. 79-80 (1982), which directed the Commission to adopt rule 4.5, explains in pertinent part:

> [S]ince virtually all of the persons or entities to which this exception would apply are regulated by other Federal or State agencies, it is reasonable to take them out of this regulatory mechanism. . . .
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> . . . .
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> . . . Therefore, while the Commission should retain discretion in this area, the Committee believes that, unless otherwise inappropriate, exemption by rule, regulation or order from [CPO] registration and related requirements . . . should generally be granted to these classes of entity. (Emphasis added.)

Fund's commodity interest trading; 8/ and (2) the Company must agree to comply with whatever rule the Commission may adopt to exempt from registration as a CTA -- or to require registration as a CTA -- persons who are registered as an IA and who provide advice on commodity interest trading to registered investment companies who have claimed exclusion from the CPO definition pursuant to Rule 4.5. Moreover, this position is strictly limited to the facts of this case. In the event the Company provided advice on commodity interest trading to one or more other registered investment companies, this position would no longer obtain.

Alternatively, you requested that we confirm that the Company would be exempt from registration as a CTA pursuant to Section 4m(1) of the Act, 7 U.S.C. §6m(1) (1982), which provides in pertinent part that the requirement to register as a CTA does not apply to any CTA --

> who, during the course of the preceding twelve months, has not furnished commodity trading advice to more than fifteen persons and who does not hold himself out generally to the public as a commodity trading advisor.

In support of that request, you contended, among other things, that the Fund should be viewed as one person for purposes of Section 4m(1). In response, we note, however, that the Court of Appeals for the Ninth Circuit has held that a person who furnishes trading advice to a futures commission merchant which "incorporate[s] that advice directly into actual transactions" for its discretionary account customers who number more than fifteen people is thus furnishing trading advice to more than fifteen people. CFTC v. Savage, 611 F.2d 270, 281 (9th Cir. 1979). 9/ Moreover, it appears that by

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8/ We expect that those books and records would be in the nature of those required of registered CTAs by Rule 4.32, 17 C.F.R. §4.32 (1985).

9/ Cf. Section 203(b)(3) of the Investment Advisers Act of 1940, 15 U.S.C. §80b-3(b)(3) (1982), which explicitly makes a similar exemption from registration under that act unavailable to an IA to any registered investment company, and the legislative history of that Section which provides:

> The Commission's authority to oversee the activities of investment advisers should not depend (as it now does) on whether they offer their services to the public directly or through the medium of an investment company. The shareholders of investment companies should have the same protections now provided for clients of investment advisers who obtain investment advice on an individual basis. H.R. Rep. No. 91-1382,

(Footnote continued)

solicitations to members of the public made through the Fund's marketing materials -- e.g., its prospectus, the Company specifically will "hold itself out" as providing advice on commodity interest trading and, thus, as acting as a CTA. Accordingly, we are granting the "no-action" position on separate grounds, as indicated above.

We note that this letter does not excuse the Company from compliance with any other applicable requirements contained in the Act or in the Commission's regulations thereunder. For example, it would remain subject to the anti-fraud provisions of Section 4o of the Act, 7 U.S.C. §6o (1982), and to the reporting requirements for traders set forth in Parts 15, 18 and 19 (1985).

This letter is based upon the representations made to us and is subject to compliance with the two conditions stated above. Any different, changed or omitted facts might require us to reach a different conclusion. In this connection, we request that you notify us immediately in the event that the Company's CTA activities change in any way from that as represented to us.

Very truly yours,

Andrea M. Corcoran
Director

(Footnote continued)

39-40 (1970), reprinted in Fed. Sec. L. Rep. (CCH) ¶56,227, p.44,071.