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

DIVISION OF
TRADING AND MARKETS

86-13

July 1, 1986

Re: Regulatory Requirements Applicable to Certain Persons Involved with Commodity Pools

Dear Mr.:

This is in response to your letter dated June 10, 1986, as supplemented by a telephone conversation held with Division staff on June 18, 1986, wherein you requested our advice on the regulatory requirements applicable to certain persons involved with commodity pools.

Based upon the representations made in your letter, as supplemented, we understand the facts to be as follows: "A" is registered under the Commodity Exchange Act (the "Act") as a commodity trading advisor ("CTA"). "B" is registered under the Act as an introducing broker ("IB") and a commodity pool operator ("CPO"). The same two persons own all of the stock of each corporation.

A securities marketer for a group of financial planners (the "Representative") has expressed interest in bringing to "A" one or more "limited partnership pools" which independently would qualify the CPO thereof for exemption from registration under Rule 4.13(a)(2), 17 C.F.R. §4.13(a)(2) (1985). 1/ In this regard, the Representative would "find and qualify persons

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1/ Rule 4.13(a)(2) provides that a person is exempt from registration as a CPO if:

> (i) The total gross capital contributions it receives for units of participation in all of the pools that it operates or that it intends to operate do not in the aggregate exceed $200,000; and
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> (ii) None of the pools operated by it has more than 15 participants at any time. For purposes of computing the number of participants [certain persons are excluded].

or entities interested in serving as 'General Partner/CPO'" of one of these pools. The Representative also would "introduce" the "CPO" to "B", which would serve as the pool's IB and would receive brokerage commissions generated therefrom and to "A", which would serve as the pool's CTA and would receive management and incentive fees. The "CPO" would be compensated by receiving a percentage of the brokerage commissions and the Representative would receive a percentage of those commissions.

The term "commodity pool operator" is defined in Section 2(a)(1)(A) of the Act, 7 U.S.C. §2 (1982), to mean:

> any person engaged in a business which is of the nature of an investment trust, syndicate or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds . . . for the purpose of trading in [commodity interests]. (Emphasis added.)

Section 4m(1) of the Act, 7 U.S.C. §6m(1), requires each person who comes within the CPO definition to register as a CPO under the Act. Rules 4.21, 4.22 and 4.23, 17 C.F.R. §§4.21, 4.22 and 4.23 (1985), respectively prescribe certain disclosure, reporting and recordkeeping requirements for registered CPOs. If a person is exempt from registration as a CPO, it is not subject to compliance with those rules. In this regard, in adopting Rule 4.13 -- which provides for exemption from CPO registration -- the Commission stated:

> The CPO exemptions are being granted because the costs of compliance with the Part 4 rules outweigh the benefits to be gained from regulating family, club and small pools. 44 Fed. Reg. 1918 at 1919 (January 8, 1979). 2/

The instant case is not, however, one where individual CPOs of the type contemplated by Rule 4.13 independently and on their own will seek out the Representative to assist in soliciting participants to form a pool of the type specified in the rule. Rather, the Representative is seeking those "CPOs" out to, in turn, solicit for him. In this regard, in your telephone conversation with Division staff you were unable to offer any support that the terms and conditions of each pool offering would be individually developed and structured by a "CPO" -- and not a mere form developed by "A" and the Representative, about which staff expressed concern. Thus, we disagree with your assertion that the Representative will be acting on behalf of each "CPO." It is the Representative himself who will be "engaged in a

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2/ In connection with proposing amendments to Rule 4.13 the Commission reaffirmed the purpose of the exemptions available under the rule. See 45 Fed. Reg. 51600 at 51601 (August 4, 1980).

business" of the type contemplated by the CPO definition with the individual "CPOs" acting as his associated persons ("APs"). 3/ To the extent that an individual "CPO" was not a natural person, however, it would be required to register as an IB. 4/

We previously had occasion to render advice with respect to a similar scheme in Division of Trading and Markets Interpretative Letter No. 84-9, Comm. Fut. L. Rep. (CCH) ¶22,092 (March 1, 1984). In that case, a Licensor, who was registered as a CTA, had licensed its computerized trading program to various licensees, each of whom similarly was registered as a CTA. The terms of the licensing agreement provided that a licensee could accept all of the signals generated by the trading program or exercise its own discretion in deciding which signals to accept. The agreement did not, however, require a licensee to exercise its own discretion. In fact, in reviewing the Disclosure Documents filed by the CTA licensees the Division found that, with limited exception, those Documents did not disclose any past performance in the management or direction of commodity trading accounts, prior commodity related experience or commodity trading for personal accounts. Moreover, the Licensor also operated a subsidiary, the Service Bureau, which for a fee performed certain tasks for some, but not all of the licensees -- e.g., receiving the computer signals generated by the program from the Licensor and placing the resulting orders on behalf of the licensee with the futures commission merchant.

On these facts, the Division took the view that the Licensor would be a Co-CTA with its licensees for the following reasons: (1) the Licensor would remain continuously involved in the operation of the program; and (2) the licensees would depend heavily if not exclusively on the signals generated by the program for the selection of trades. With respect to this second factor, the Division noted in particular that the expectation that the licensees would rely on the Licensor to direct trading rather than exercise their own discretion would be consistent with the licensees' lack of experience in commodity interest trading. The Division further noted, however, that:

> [T]o the extent the licensees contract with the Licensor to receive the trading signals generated by the

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3/ Section 4k(4) of the Act, 7 U.S.C. §6k(4) (1982), generally requires each person who comes within the definition of an AP of a CPO to register as such under the Act. Thus, although for different reasons, we agree with your assertion that the Representative would not be an AP of a CPO because he "will not solicit individual investor participation or aid in the raising of funds from the public."

4/ Section 4d of the Act, 7 U.S.C. §6(d) (1982), generally requires each person who comes within the IB definition to register as such.

> Licensor and to place orders with an FCM, thereby removing themselves from both the order selection and order placement processes, the licensees appear to be doing nothing more than soliciting customers on behalf of the Licensor. In such cases, the Division believes that a licensee may be more properly registered not as a CTA but as an [AP] of the Licensor, if an individual, or as an [IB], if organized as a corporation, a partnership or other form of association. Id. at 28,831-32.

The conclusions reached in that case similarly apply to the instant one in light of the fact, as noted above, that there is no evidence that the "CPOs" will have any commodities-related experience or that they will exercise any discretion in the formation or operation of their pools. Rather, the "CPOs" will merely be acting upon the order and direction of the Representative. Thus, and as noted above, we believe that the Representative would be acting as a CPO and that those persons that you have denominated as "CPOs" would be acting as an AP of a CPO (if a natural person) or as an IB (if not a natural person).

The opinions expressed in this letter are based upon the representations that have been made to us and are strictly limited to those representations. 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 the Representative's proposed operations change in any way from that as represented to us.

Very truly yours,

Andrea M. Corcoran
Director

cc: Daniel A. Driscoll, National Futures Association