



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Swap Dealer and
Intermediary Oversight

Gary Barnett
Director

CFTC Letter No. 14-160
No-Action
December 18, 2014
Division of Swap Dealer and Intermediary Oversight

Re: No-Action relief from the reporting requirements pursuant to Commission regulations 4.7(b) and 4.27(c) for “A”

Dear :

This is in response to your letter (the “Letter”), dated July 15, 2014, to the Division of Swap Dealer and Intermediary Oversight (the “Division”) of the U.S. Commodity Futures Trading Commission (the “Commission” or “CFTC”). On behalf of “A”, you request no-action relief for “A” from the following requirements with respect to “B” and “C”:

1. Prepare and file with the National Futures Association (“NFA”) and distribute to each participant an annual report with audited financial statements pursuant to Commission regulations 4.7(b)(3) and 4.22(d).
2. Prepare and distribute periodic statements to pool participants pursuant to Commission regulation 4.7(b)(2).
3. Prepare and file with NFA a report with respect to the directed assets of each pool under the advisement of “A” consistent with appendix A of Part 4 (*i.e.*, Form CPO-PQR) pursuant to Commission regulation 4.27(c).¹

Background Facts

Based on the Letter and other supplemental correspondence (the “Correspondence”) and publicly available regulatory filings, we understand the facts to be as follows. You state that “A” operates “D”, “B”, and “C”. You state that “D” is a New York Stock Exchange-listed specialty finance company that is registered with the U.S. Securities and Exchange Commission under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, and operates pursuant to Commission regulation 4.12(c). “D” acquires and manages mortgage-related assets, including residential mortgage-backed securities (“RMBS”) backed by prime jumbo, Alt-A, manufactured housing, and subprime residential mortgage loans; RMBS for which the principal and interest payments are guaranteed by a U.S. government agency or a U.S.

¹ The Letter also requests relief from filing NFA Form PQR pursuant to NFA rules. The Division is unable to grant “A” relief from any NFA requirements. “A” should request relief from NFA directly.

government-sponsored enterprise; residential mortgage loans; mortgage-related derivatives; commercial mortgage-backed securities; commercial mortgage loans and other commercial real estate debt, as well as corporate debt and equity securities; and derivatives.

You state that “B” is the intermediate holding company under “D” and operates pursuant to Commission regulation 4.7(b). You state that “D” owns 99.19% of “B” and that the rest of the interests are split between “E”, which owns 0.31%, and the family trusts of “F” and “G”, which own 0.50%. You state that “E” is the owner of 99% of the interests of “A”. You state that the remaining 1% is owned by “H”, an entity that is 99% owned by “G” and 1% owned by his wife. You state that “F” and “G” are principals and associated persons of “A” and principals of “E”. Furthermore, you state that “F” is the Chief Executive Officer, President, and a director of “D” and “G” is the Co-Chief Investment Officer and director of “D”. With respect to the family trust of “F”, you state that it is solely funded by “F” and his wife; with respect to the family trust of “G”, you state that it is solely funded by “G” and his wife.

You state that “C” is the wholly-owned subsidiary of “B”. “C” owns securities, including various kinds of mortgage-related securities, and you state that it is a vehicle through which commodity interest investments are conducted. “C” relies on the exemption provided by section 3(c)(7) of the Investment Company Act of 1940, as amended, and you state that it also operates pursuant to Commission regulation 4.7(b).

You state that “D” formed “B” because it was thought that this structure would provide additional operational flexibility, and would further align the interests of the management team of “A”, “D”, and “B” by shifting a portion of the investment of “D’s” management team from freely tradable “D” shares into interests in “B” that are subject to significant liquidity restrictions.

You state that with respect to “D”, which is a public company, “A” prepares an annual report that contains audited financial statements that consolidate the financial information of “B”, “C”, and other direct and indirect subsidiaries of “D” pursuant to U.S. generally accepted accounting principles. You state that “A” files this with the U.S. Securities and Exchange Commission (“SEC”) and the NFA, and also distributes it to its participants pursuant to SEC and Commission requirements. You state that this annual report includes a detailed consolidated schedule of investments of “B” and its subsidiaries.² Furthermore, you state that “D” provides its consolidated periodic account statements required pursuant to Commission regulations 4.12(c) and 4.22(a) and (b) on its website.

Request for Relief

“B” and “C” are both commodity pools that are operated by “A” pursuant to an exemption under Commission regulation 4.7(b). As a result, each is a commodity pool that is

² The consolidated schedule of investments may also include investments made by additional subsidiaries that are not commodity pools, the financial information of which may be consolidated without relief from the Commission or the Division.

separate and apart from its respective parent pools and “A” has periodic statement, annual report, and Form CPO-PQR requirements with respect to each pool.³

Specifically, “A” must prepare and distribute periodic statements to pool participants pursuant to Commission regulation 4.7(b)(2) and prepare and file with NFA and distribute to each participant an annual report with audited financial statements pursuant to Commission regulations 4.7(b)(3) and 4.22(d). However, because “A” is the CPO of “D”, “B”, and “C”, the periodic statements and annual reports of “B” and “C” do not need to be distributed to “D” and “B”, respectively, pursuant to Commission regulation 4.22(a)(4) and (c)(8). “B” would still need to distribute its periodic statements and annual reports to “E” and “F” and “G” Family Trusts and file its annual reports with NFA. Also, “C” would still need to file its annual reports with NFA. Furthermore, “A” must prepare and file with NFA the information in Form CPO-PQR pursuant to Commission regulation 4.27(c) for both “B” and “C”.⁴

You request no-action relief for “A” from the following requirements with respect to “B” and “C”:

1. Prepare and file with NFA and distribute to each participant an annual report with audited financial statements pursuant to Commission regulations 4.7(b)(3) and 4.22(d).
2. Prepare and distribute periodic statements to pool participants pursuant to Commission regulation 4.7(b)(2).
3. Prepare and file with NFA a report with respect to the directed assets of each pool under the advisement of “A” consistent with Appendix A of Part 4 (*i.e.*, Form CPO-PQR) pursuant to Commission regulation 4.27(c).

With respect to your relief request in connection with the periodic statement and annual report requirement pursuant to Commission regulations 4.7(a)-(c) and 4.22(d), you state that “E” and “F” and “G” Family Trusts have sufficient access to the financial information of “B”.

First, you note that the financial information in the annual reports and periodic account statements of “D” is essentially identical to that of “B”. You state that this is because “D” puts 100% of its money into “B” and “D” conducts all of its operations and business activities through “B”. You also state that the respective interests owned by “D”, “E”, and “F” and “G” Family Trusts have the same pro rata exposure to the performance of “B”. As a result, you state that the financial information provided by “D” can adequately stand in for the information for “B”.

Second, you note that this financial information is readily available to “E” and “F” and “G” Family Trusts, as this information is all publicly available.

³ The Division notes that, absent the relief provided herein, “A” could take advantage of CFTC Staff Letter 14-112 and consolidate “C’s” financial information within “B’s” annual report.

⁴ The Division notes that, absent the relief provided herein, “A” could take advantage of CFTC Staff Letter 14-112 and consolidate “C’s” CPO-PQR information within “B’s” Form CPO-PQR information.

Third, you note the role of “E” and “F” and “G” within the “A” [fund] structure that would grant them access to inside information concerning “B” and “C”. You note that “E” owns 99% of “A”, which is the CPO for both “B” and “C”. You also note that “F” and “G” are principals and associated persons of “A” and also principals of “E”. Furthermore, you note that “F” is the Chief Executive Officer, President, and a director of “D” and “G” is the Co-Chief Investment Officer and a director of “D”.

Furthermore, you note that “E” and “F” and “G” Family Trusts have agreed in writing to not receive any annual reports and periodic account statements of “B”. You also state that “A” will distribute the annual reports and periodic account statements of “D” to “E” and “F” and “G” Family Trusts.

With respect to your relief request in connection with filing Form CPO-PQR information with NFA pursuant to Commission regulation 4.27(c), you argue that providing consolidated Form CPO-PQR information for “D” would remove unnecessary complexity and provide more useful information.

Relief granted

Commission regulation 4.7(b) requires a registered CPO to distribute periodic statements and an annual report to each participant in each pool operating pursuant to Commission regulation 4.7(b) that it operates and electronically submit a copy of the annual report and key financial balances from the annual report to the NFA. The principal purpose of the financial reporting required by Commission regulation 4.7(b) is to ensure that pool participants receive accurate, fair, and timely information on the overall trading performance and financial condition of the pool.

Commission regulation 4.27(c) requires a registered CPO to prepare and file with NFA a report with respect to the directed assets of each pool under the advisement of the CPO consistent with Appendix A of Part 4 (*i.e.*, Form CPO-PQR). The purpose of this requirement is so that the Commission can assess risk posed by investment vehicles to derivative markets and the broader financial system.⁵

Based on the representations made in the Correspondence, the Division believes that your no-action relief request has merit. Accordingly, with respect to “B”, the Division will not recommend that the Commission take an enforcement action against “A” for failure to:

1. Prepare and file with NFA and distribute to “E” and “F” and “G” Family Trusts an annual report with audited financial statements pursuant to Commission regulations 4.7(b)(3) and 4.22(d); or
2. Prepare and distribute periodic statements to “E” and the “F” and “G” Family Trusts pursuant to Commission regulation 4.7(b)(2).

⁵ 77 FR 11252, 11266 (Feb. 24, 2012).

“A”

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Also, with respect to “C”, the Division will not recommend that the Commission take an enforcement action against “A” for failure to prepare and file with NFA an annual report with audited financial statements pursuant to Commission regulations 4.7(b)(3) and 4.22(d)

However, with respect to the Form CPO-PQR requirement of Commission regulation 4.27(c), the Division declines to provide the relief requested. Instead, the Division will not recommend that the Commission take an enforcement action against “A” for failure to prepare and file with NFA a report with respect to the directed assets of “D” under the advisement of “A” consistent with Appendix A of Part 4 (*i.e.*, Form CPO-PQR) pursuant to Commission regulation 4.27(c); provided, that “A” prepares and files such a report with respect to the directed assets of “B”. The Division believes that this is appropriate, given that “B” is the pool that contains all of the assets that are being invested by this “A”[fund] structure.

This letter, and the positions taken herein, represents the view of this Division only, and does not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The relief issued by this letter does not excuse persons relying on it from compliance with any other applicable requirements contained in the Commodity Exchange Act or in the Commission regulations issued thereunder. Further, this letter, and the relief contained herein, 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 relief provided herein, in its discretion.

Should you have any questions, please do not hesitate to contact Amanda Olear, Associate Director, at 202-418-5283, or Chang Jung, Special Counsel, at 202-418-5202.

Very truly yours,

Gary Barnett
Director
Division of Swap Dealer and
Intermediary Oversight