CFTC Letter No. 01-40
April 20, 2001
Other Written Communication
Division of Trading and Markets

> Re: Section 105(a) of the Commodity Futures Modernization Act; “X”
> “Y”; Request for Confirmation of the Availability of the Exclusion from the Commodity Exchange Act for Certain Hybrid Instruments

Dear:

This is in response to your letter dated February 10, 2001 (“February Letter”) to the Commission’s Acting Chairman, which has been referred to this office for reply. The February Letter describes the “X” contract (“X”) that you seek to issue to members of the public through “Y” a Delaware limited liability company.

In the February Letter, you state your view that “X” complies with all the requirements for exclusion from the Commission’s jurisdiction under section 105(a) of the Commodity Futures Modernization Act (“CFMA”), P.L. 106-554, 114 Stat. 2763 (to be codified at 7 U.S.C. § 2(f)). Specifically, you state that “X” is “predominantly a security” within the meaning of Section 105 of the CFMA because:

> (a) The issuer receives payment in full at the time the instrument is issued; (b) “X” is fully paid; an owner can not be required to make any additional payments over the life of the instrument; (c) The issuer is not required by terms of the “X” agreement to meet mark-to-market margining requirements; the issuer does, however, hedge itself in order to maintain the value of the assets backing the instrument; and (d) “X” will not be offered as a contract of sale of a commodity for future delivery (or an option on such a contract) subject to the CEA.

February Letter, at 1-2.

The February Letter seeks advice on whether you must formally withdraw your November 20, 1998 Petition for Exemption from the Commodity Exchange Act (“Petition”). You also seek advice as to whether you should proceed to register “X” as a security with the Securities and Exchange Commission (“SEC”).

As you correctly note, Section 105(a) of the CFMA provides an exclusion from Commission jurisdiction for hybrid instruments that are predominantly securities. Section 105(a) sets forth a four-part test for determining predominance. The exclusion under Section 105(a), however, is self-executing. That is, if the exclusion is available, it may be claimed without Commission action. In light of the self-effectuating nature of the exclusion in section 105(a) of the CFMA, your Petition is being treated as withdrawn.

You should seek advice from the SEC regarding the issue of whether “X” should be registered as a security.

If you have any questions concerning this correspondence, please contact Helene D. Schroeder, an attorney on my staff, at (202) 418-5450.

Very truly yours,

John C. Lawton
Acting Director