84-13

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

DIVISION OF
TRADING AND MARKETS

August 1, 1984

Re: --
Regulation as a commodity pool operator.

Dear :

This is in response to your letter dated June 19, 1984, as supplemented by the prospectus dated March 29, 1984 enclosed therewith (the "Prospectus"), in which you requested that we not recommend that the Commission take any enforcement action against (the "Fund") for failure to register as a commodity pool operator ("CPO") subject to the conditions and limitations described below.

From the representations made in your letter, as supplemented, we understand the facts concerning the Fund's operation in general to be as follows: The Fund is a series investment company registered under the Investment Company Act of 1940. It currently is offering shares in the following four investment Portfolios: (1) the Government Money Market Portfolio, which seeks high current income and stability of principal by investing in short-term U.S. obligations; (2) the Money Market Portfolio, which seeks high current income and stability of principal by investing in a variety of short-term instruments; (3) the High Yield Bond Portfolio, which seeks to maximize total return from capital appreciation and current income by investing generally in certain debt securities; and (4) the Aggressive Growth Portfolio, which seeks to maximize capital appreciation by investing primarily in common stocks and securities convertible into common stocks.

The first two Portfolios do not intend to engage in commodity futures transactions. The second two Portfolios, however, do. Specifically, the High Yield Bond Portfolio intends to trade financial futures contracts and the Aggressive Growth Portfolio intends to trade stock index futures contracts. Your letter makes the following representations with respect to each such Portfolio's commodity futures trading:

> The Fund's sale and purchase of . . . futures contracts will be for bona fide hedging purposes only and not for speculation, with the purpose of offsetting anticipated price changes in securities held by the particular Portfolio or which the particular Portfolio anticipates purchasing. A hedging transaction is intended to reduce risk of loss, not increase it.

> In order to protect against an anticipated decline in the value of . . . [a] Portfolio due to general market conditions or changing interest rates, the particular Portfolio would enter into a short hedge by selling a futures contract, instead of liquidating or adjusting its portfolio securities and incurring the incident transaction charges. To the extent that subsequent decreases in futures prices produced gains in the particular Portfolio's futures position that offset the decline in the value of the Portfolio, gains on the futures position would offset the particular Portfolio's loss on its portfolio securities. Further, to the extent that prices in the futures market moved in correlation to the prices of the securities comprising the hedging Portfolio, any losses in the Portfolio's futures positions should be offset by increases in the value of its portfolio securities.
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> When . . . [a] Portfolio wishes to remain in short-term instruments because such instruments are desirable for defensive purposes or because such are otherwise advantageous, and at the same time wishes to avoid the risk that it may have to pay higher prices for portfolio securities it intends to acquire in the future, the particular Portfolio would enter into a long hedge by purchasing . . . [a] futures contract. . . . [T]o the extent that an increase in the Portfolio's futures position offset the higher prices to be paid by the Portfolio in the future for long-term investments, gains in the Portfolio's futures position would offset such increases in prices. Further, to the extent that futures prices move in correlation to the prices of securities held by the Portfolio, any losses on the Portfolio's futures positions should be offset by any difference between what it pays for the long-term investment and the larger price it would have paid for such investment if it had purchased it with cash. . . . [T]he Fund represents that, to insure that all of its commodity interest trading is for bona fide hedging purposes, the Fund will "complete" its purchases of interest rate futures contracts and stock index futures contracts a substantial majority (i.e., approximately 75%) of the time. 1/
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> Additionally, the Fund's fundamental policies provide that . . . [each] Portfolio may not enter into . . . futures contracts if, immediately after such a commitment, more than 5% of the particular Portfolio's total assets would be posted as initial and variation margin.

As you are aware, on February 2, 1984, the Commission issued proposed Rule 4.5, which would exempt certain otherwise regulated persons from registration as a CPO and from the provisions of Subpart B of Part 4 of the

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1/ We note that such a representation concerning completion of long commodity interest hedges -- be they in stock index or financial commodity interests -- is one of the representations we require to grant relief from CPO regulation.

Commission's regulations. 2/ See 49 Fed. Reg. 4778 (February 8, 1984), 49 Fed. Reg. 6910-11 (February 24, 1984). Based upon our review of the representations made in your letter, as supplemented, it appears that the Fund would be eligible for this proposed exemption inasmuch as: (1) the Fund is among the persons and qualifying entities covered by the proposal -- i.e., a registered investment company; (2) each of its two Portfolios that will engage in commodity interest transactions will do so solely for bona fide hedging purposes; (3) each of these Portfolios will not deposit as initial margin or premiums for its commodity interest transactions more than 5% of its total assets; (4) the Fund will not be, and has not been, marketed as a commodity pool or otherwise as a vehicle for trading in the commodity interest markets; and (5) the Fund will disclose in writing to its prospective participants the purpose of and the limitations on the scope of its commodity interest trading.

Proposed Rule 4.5 does not specifically address the instant situation -- i.e., where only certain portfolios of a registered series investment company intend to engage in commodity interest transactions. However, in light of the separate ownership in and identities of the Fund's Portfolios -- e.g., separate investment objectives, net asset valuations and dividend policies -- we believe it consistent with the intent of proposed Rule 4.5 to treat as separate entities each of the two Portfolios that intend to engage in commodity interest trading for purposes of determining whether the criteria of the proposal have been met. 3/ Conversely, where such separate ownership and identities are not present, we might find it more consistent with proposed Rule 4.5 to aggregate all of the portfolios of a series investment fund in determining whether the criteria has been met.

Accordingly, this Division will not recommend that the Commission take any enforcement action against for failure to register as a CPO or to comply with the provisions of Subpart B of Part 4 of the Commission's regulations. 4/ This position is, however, subject to the condition that the Fund will comply with Rule 4.5 as adopted by the Commis-

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2/ Section 4m(1) of the Act, 7 U.S.C. §6m(1) (1982), requires each person who comes within the CPO definition to register as a CPO with the Commission. The provisions of Subpart B of Part 4 concern the operational, disclosure, reporting and recordkeeping requirements of registered CPOs. See 17 C.F.R. §§4.20-4.23 (1983), as amended by 48 Fed. Reg. 35248 (August 3, 1983).

3/ With respect to a series investment company such as the Fund we believe this determination particularly appropriate to the "hedging" and "5%" criteria. A contrary finding would enable a Portfolio to commit 5% of the Fund's total assets for its commodity interest positions which, in turn, might enable the Portfolio to commit more assets than are necessary to hedge its own, separate actual or anticipated cash positions.

4/ Inasmuch as proposed Rule 4.5 would provide exemption for a registered investment company and any principal or employee thereof, the position we are taking herein also would apply to any principal or employee of the Fund -- e.g., its officers.

sion or with any other such rule that the Commission may adopt to exempt certain otherwise regulated persons from regulation as a CPO. 5/ Therefore, this position will cease upon the effective date of Rule 4.5 or of such other rule.

In this connection, we note that previously we have issued opinions to certain registered investment companies that they would not be pools within the meaning and intent of Rule 4.10(d) based upon representations similar to those made by the Fund. 6/ However, in light of the Commission's recent proposal in this area, we believe that such a "no-action" position is the appropriate relief that should be afforded at this time. We further note that with respect to such investment companies and the filing of certain notices proposed in Rule 4.5, the Commission has stated:

> [We do] not believe that it should be necessary for the recipients of such interpretative letters to, in effect, "re-submit" an application for exemption -- i.e., to file an initial notice of eligibility -- in the event the proposal is adopted. However, to insure that these persons (and entities) would be in compliance with the requirements of the proposed rule, the Commission intends to take the position that such persons must file supplemental notices in the event that any of the representations they previously had made to the Commission changed or that, to the extent that the proposal would require any additional representations, they were not in compliance with them. This position would ensure equal treatment of all persons claiming exemption under the rule. 49 Fed. Reg. 4778 at 4782-83. 7/

5/ For example, the rule as adopted may or may not contain the same standards and indicia of bona fide hedging transactions and positions contained in the rule as proposed. Moreover, to the extent that the rule as adopted is less restrictive than the rule as proposed -- with respect to the standards and indicia of bona fide hedging transactions and positions or to any other aspect of the proposal -- the Fund would be able to trade commodity interests subject to such other restrictions provided, of course, that such trading is conducted in accordance with the rule as adopted.

6/ See _____, Comm. Fut. L. Rep. (CCH) ¶21,908 (available November 3, 1983); _____, Comm. Fut. L. Rep. (CCH) ¶21,906 (available October 21, 1983); _____, Comm. Fut. L. Rep. (CCH) ¶21,905 (available September 13, 1983). See also _____, Comm. Fut. L. Rep. (CCH) ¶21,910 (available November 21, 1983).

7/ Your letter represents that the Fund will comply with Rule 4.5 as adopted "to the same extent as if it had filed an application for exemption from registration as a CPO pursuant to [Rule] 4.5 and such application had been granted."

We believe, and intend to recommend, that the Commission should take this same position with respect to the Fund. 8/

You should be aware that the position we have taken in this letter does not excuse the Fund from compliance with any otherwise applicable requirements contained in the Act or in the Commission's regulations thereunder. For example, it remains 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 of the Commission's regulations, 17 C.F.R. Parts 15, 18 and 19 (1983), as amended.

The position we have taken herein is based upon the representations that have been made to us. Any different, changed or omitted facts or conditions might require us to reach different conclusions. In this connection, we request that you notify us immediately in the event the Fund's operations and activities change in any way from that as represented to us.

Very truly yours,

Andrea M. Corcoran
Director

8/ We historically have treated registered investment companies and their officers and directors as those persons subject to CPO regulation. In the unlikely event that Rule 4.5 or any other such rule as the Commission adopts includes investment advisers to and distributors of registered investment companies among the persons who could be considered to be CPOs but does not also include provision for exemption from regulation as a CPO for such persons, the Division will not recommend that the Commission take any enforcement action against the Fund's adviser, distributor, or any officer, director or employee thereof pending such persons' compliance with such requirements as the rule may impose. Of course, this position assumes that such persons will endeavor to achieve such compliance as promptly as possible.