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

DIVISION OF
TRADING AND MARKETS

85-8

February 8, 1985

Re: Regulation as a commodity pool operator.

Dear :

This is in response to your letter dated June 28, 1984, as supplemented by your letters dated August 13, 1984, January 7, 1985 and January 30, 1985 and by the enclosures with those letters, in which you requested on behalf of the 1983 Partnership and the 1984 Partnerships (the "Partnerships") our opinion that the Partnerships will not be "pools" as defined in Rule 4.10(d), 17 C.F.R. §4.10(d) (1984).

From the representations made in your June 28, 1984 letter, as supplemented, we understand the facts to be as follows: Each Partnership is a limited partnership formed under the laws of the State of New York to enable certain officers and employees of "A" and its subsidiaries (collectively the "Employers") to pool their resources to invest in certain securities. Currently, those persons eligible to invest in the Partnerships are: (1) any employee of an Employer who in the preceding year had an income from "A" of $150,000 in the case of the 1983 Partnership and $200,000 in the case of the 1984 Partnerships; (2) any retired employee who had such income in the year preceding his retirement; (3) members of such employee's immediate family; and (4) trusts established for the benefit of such employee and/or the members of his immediate family. 1/

The General Partner of each Partnership is "B," an indirect wholly-owned subsidiary of "A." Currently, the directors and officers of the General Partner are officers or employees of "C," another indirect wholly-owned subsidiary of "A". 2/ The General Partner does not, however, receive any

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1/ Among the enclosures with your correspondence were the current Private Placement Memoranda that are being employed to offer units of participation in the Partnerships to eligible persons.

2/ Our records indicate that "C" is registered with the Commission as a futures commission merchant and that it is a non-clearing member of the Chicago Board of Trade.

fees or compensation for the performance of its duties, 3/ one of which is the selection and evaluation of each Partnership's investment manager. 4/

The 1983 Partnership's primary investment objective is long-term capital appreciation, which it seeks to accomplish through investment in a variety of equity and debt securities. The 1984 Partnerships' primary investment objective is to obtain the maximum pre-tax total rate of return available from investing in municipal securities the interest on which is exempt from Federal income taxation. Each Partnership also intends to engage in certain commodity interest transactions, subject to certain limitations thereon. 5/ As your correspondence represents:

> The Partnerships will not invest in such futures contracts and related options for speculation, but only as a hedge against changes in the market values of [securities] held by the Partnerships and where the transactions are appropriate to reduction of risk. A Partnership may not enter into futures contracts or related options (other than offsetting existing positions) if immediately thereafter the sum of the amount of initial margin deposits on outstanding futures contracts and premiums paid for related options would exceed 5% of the market value of its total assets.
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> . . . [A]ll of the futures contracts that they enter into will be "bona fide hedging transactions" as

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3/ Specifically, Section 6.01(b) of the Limited Partnership Agreement of each Partnership provides:

> Officers and directors of the General Partner shall not be entitled to receive any compensation for their services, other than reimbursement for reasonable and necessary out-of-pocket expenses incurred during the course of conducting Partnership business.

Moreover, each Partnership's Memorandum states that the Employers bear "all general overhead expenses, attorneys' fees, accounting fees and similar expenses."

4/ We note that the 1983 Partnership's Memorandum and the 1984 Partnerships' Memorandum, at pages 30 and 33, respectively, state that any such investment manager will be unaffiliated with the General Partner, and any officer or director thereof.

5/ Specifically, the 1983 Partnership intends to engage in commodity interest transactions based on financial instruments and stock indices and the 1984 Partnerships intend to engage in commodity interest transactions based on United States Treasury obligations and on "Municipal Securities . . . if and when [they] become available for investment."

> defined in CFTC regulations. To ensure that their futures transactions meet this definition, the Partnerships will enter into them for the purposes and with the hedging intent specified in CFTC regulations. The Partnerships' futures transactions will be entered into for traditional hedging purposes -- that is, futures contracts will be sold (or related put options purchased) to protect against a decline in the price of securities that the Partnerships own. 6/

Your correspondence also represents that in the event a Partnership engages in any long commodity interest transactions, approximately 75% of such transactions will be completed. 7/ Finally, your correspondence represents that if any Partnership engages in commodity interest transactions in which "C" is the futures commission merchant, "C" "will perform such services at its cost."

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 commodity pool operator ("CPO") and from the provisions of Subpart B of Part 4 of the Commission's regulations. 8/ 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 each Partnership would meet four of the five criteria proposed for such exemption inasmuch as each Partnership: (1) will engage in commodity interest transactions solely for bona fide hedging purposes; (2) will not deposit as initial margin or premiums for its commodity interest transactions more than 5% of the market value of its total assets; (3) 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 (4) will disclose in writing to its prospective participants the purpose of and the limitations on the scope of its commodity interest trading. As for the fifth criteria, however, the Partnerships are not among the entities who may qualify for the proposal -- i.e., as explained below, they are not registered as investment companies under the Investment Company Act of 1940, 15 U.S.C. §80a et. seq. (1982) (the "1940 Act").

6/ These limitations also are set forth at pages 40-41 of the 1983 Partnership's Private Placement Memorandum and at pages 47-48 of the 1984 Partnership's Private Placement Memorandum.

7/ You also represent that each Memorandum will be revised to disclose this restriction.

8/ Section 4m(1) of the Commodity Exchange Act, as amended (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 (1984).

Each Partnership is an "employees' security company" as that term is defined in Section 2(a)(13) of the 1940 Act. Pursuant to Sections 6(b) and 6(e) of the 1940 Act, 9/ each Partnership has requested and received from the Securities and Exchange Commission (the "SEC") exemption from a substantial number of provisions of the 1940 Act -- e.g., from the registration require-

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9/ Sections 6(b) and (e) provide in pertinent part:

> (b) Upon application by an employees' security company, the Commission shall by order exempt such company from the provisions of this title and of the rules and regulations hereunder, if and to the extent that such exemption is consistent with the protection of investors.
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> . . . .
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> (e) If, in connection with any rule, regulation, or order under this section . . . the Commission deems it necessary or appropriate in the public interest or for the protection of investors that certain specified provisions of this title pertaining to registered investment companies shall be applicable in respect of such company, the provisions so specified shall apply to such company, and to other persons in their transactions and relations with such company, as though such company were a registered investment company.

Also among the enclosures with your correspondence were copies of the Orders of Exemption and the Applications therefor. Each Application represents that employees eligible to participate in a Partnership comprise:

> (a) senior traders at "C" and at "D," a wholly-owned subsidiary of "A," (b) senior analysts and salesmen and senior members of the corporate finance, municipal finance and real estate finance departments at "C" and (c) executive officers at "A," "C" and "D," department heads at "D" and heads of the operations departments at "B." Employees eligible under clause (a) or (b) of the preceding sentence make daily investment decisions for their respective Employers in the course of performing their duties; employees eligible under clause (c) either make such investment decisions or design, implement and/or analyze trading or investment strategies and activities for their respective Employers.

ment in Section 8 -- although not from certain anti-fraud and fiduciary provisions. 10/ As a condition of such relief, however, each Partnership was required by the SEC to comply with the semi-annual filing requirements of the SEC's annual report form, Form N-SAR, for registered investment companies.

Based upon the foregoing, we believe that the instant situation merits such relief as proposed Rule 4.5 would afford. Our belief is based upon, among other things, the following factors: (1) the Partnerships satisfy four of the five criteria of proposed Rule 4.5; (2) the nature of the persons who may become participants in the Partnerships; (3) the General Partner will receive no fees or compensation for its services; (4) "C" will execute the Partnerships' commodity interest transactions at its cost; and (5) the Partnerships remain subject to certain fiduciary, anti-fraud and reporting requirements under the 1940 Act.

Accordingly, this Division will not recommend that the Commission take any enforcement action against "B" for failure to register as a CPO or to comply with the provisions of Subpart B of Part 4 of the Commission's regulations with respect to the Partnerships. 11/ This position is, however, subject to the condition that other than being specified as an "eligible person" -- i.e., an investment company re- gistered as such under the 1940 Act, the General Partner will meet and comply with the requirements of Rule 4.5 as adopted by the Commission or with any other such rule that the Commission may adopt to exempt certain otherwise regulated persons from regulation as a CPO. 12/ Therefore, this position will cease upon the effective date of Rule 4.5 or of such other rule.

10/ Specifically, you state that the Orders exempt the Partnerships from "each and every provision of the 1940 Act other than Section 9, Sections 17(a) and 17(d) (subject to certain exceptions), and Sections 36(a), 36(b) and 37 through 53." The final enclosure with your correspondence was a summary of the provisions of these sections. We note that, among other things, these provisions: prohibit persons who have violated the securities laws from serving as directors or officers of a registered company (Section 9); subject directors and officers of a registered investment company to suit by the SEC for breach of fiduciary duty involving personal misconduct (Section 36(a)); make conversion or embezzelment of property of a registered investment company a Federal crime (Section 37); and render void any provision binding any person to waive compliance with the 1940 Act (Section 47).

11/ 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 General Partner -- e.g., its officers.

12/ For example, the rule as adopted may or may not contain the same standards and indicia of bona fide hedging transactions and positions

(Footnote Continued)

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 with respect to the Partnerships. 13/ However, in light of the Commission's 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.

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

You should be aware that the position we have taken in this letter does not excuse the General Partner 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 (1984).

(Footnote Continued)

> 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 -- each Partnership 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.

13/ See Pension Hedge Fund Inc., Comm. Fut. L. Rep. (CCH) ¶21,908 (available November 3, 1983); SteinRoe Bond Fund, Inc., Comm. Fut. L. Rep. (CCH) ¶21,906 (available October 21, 1983); Prudential-Bache Option Growth Fund, Inc., Comm. Fut. L. Rep. (CCH) ¶21,905 (available September 13, 1983). See also Piedmont Income Fund, Inc., Comm. Fut. L. Rep. (CCH) ¶21,910 (available November 21, 1983).

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 any Partnership's operations and activities change in any way from that as represented to us.

Very truly yours,

Andrea M. Corcoran
Director