COMMODITY FUTURES TRADING COMMISSION
2033 K STREET, N.W., WASHINGTON, D.C. 20581
(202) 254-8955
(202) 254-3534 FACSIMILE

DIVISION OF
TRADING AND MARKETS

91-1

January 18, 1991

Re: and

Dear :

This is in response to your letter dated August 9, 1990, as supplemented by conversations with Division staff, wherein you request on behalf of and , registered commodity trading advisors ("CTAs"), (1) exemption from Rules 4.31(a)(3) and 4.21(a)(5) 1/ and (2) an interpretation that and fall within the purview of Rule 1.46(d)(6)(i).

Rule 4.31(a)(3) requires a CTA to include in its Disclosure Document the actual performance record of all accounts directed by the CTA and each of its principals for the three years preceding the date of the Document. Rule 4.21(a)(5) requires a commodity pool operator ("CPO") to include in its Disclosure Document the actual performance record of all accounts (other than the pool for which the Document is being delivered) directed by the pool's CTA and each of its principals for the three years preceding the date of the Document. The term "principal" is defined in Rule 4.10(e) to mean:

> (1) Any person including, but not limited to, a sole proprietor, general partner, officer or director, or person occupying a similar status or performing similar functions, having the power, directly or indirectly, through agreement or otherwise, to exercise a controlling influence over the activities of the entity;

1/ Commission rules referred to herein are found in 17 C.F.R. Ch. I (1990).

(2) Any holder or any beneficial owner of ten percent or more of the outstanding shares of any class of stock of the entity; and

(3) Any person who has contributed ten percent or more of the capital of the entity.

Rules 4.21(h) and 4.31(g) respectively require CPOs and CTAs to disclose all material information, even if the information is not specifically required by Rules 4.21 and 4.31.

Rule 1.46 generally requires a futures commission merchant to offset long and short commodity futures or options positions in a customer account or option customer account. Rule 1.46(d)(6)(i) provides an exception to this general requirement for purchases and sales of commodity futures or option contracts made in separate accounts owned by one customer provided that, among other things, the trading in such accounts is directed by two or more persons acting independently, each of which is directing the trading of a separate account.

Based upon the representations made to us, we understand the facts to be as follows. has been registered as a CTA since 1984. It has over $1.1 billion in managed accounts. The trading systems are technical and nondiscretionary in that (1) all orders are computer-generated after the close for execution in the next day's market, and (2) absent extraordinary circumstances, no intervention to modify the computer-generated order selection is permitted. became registered as a CTA in March 1990. It is owned 10% by , and the family as its general partners and 90% by as its limited partner. 's trading system, which also is technical and non-discretionary in nature, was developed by Messrs. and , who first joined efforts to develop such a system in 1985. Mr. , who also is registered as a CTA, managed customer accounts from 1986 to mid-1988. and jointly have managed customer accounts since 1988. Accordingly, you conclude that it would not be materially misleading to prospective investors if did not disclose 's past performance and Mint did not disclose 's past performance.

The April 1, 1990 Disclosure Document filed with the Commission for makes the following statement about 's participation in 's affairs (the "Participation Statement"): 2/

2/ In this regard, we note that your request was filed with the

(Footnote Continued)

> [a and affiliate] and Messrs. and will have sole management authority over the day-to-day activities of , and will be solely responsible for its nondiscretionary, technical trading program. Although is a 90% shareholder of , none of the principals of and none of their principals will be involved in the daily operations of and will not participate in any of its trading activities. Messrs. , and will be involved in developing planning initiatives, including marketing plans.

In lieu of including past performance information for , the Document makes the following statement (the "Relief Statement"):

> Pursuant to an exemption from disclosure obtained from the Division of Trading and Markets of the CFTC, this Disclosure Document does not present any performance results achieved by , the limited partner of , or of any of its principals. At the request of the Division, the following prescribed language is provided:
>
> Pursuant to Part 4 of the CFTC's regulations, a principal's performance is required to be disclosed. However, has received an exemption from this requirement from the CFTC on the basis that the non-inclusion of 's performance would not be materially misleading to investors and, additionally, upon the representations of and its principals, as the majority owners of , that they will not participate directly or indirectly in 's trading activities. However, in the event of an investor or a prospective investor request, will immediately provide a copy of 's past performance.

In further support of your request you note that Messrs. and will serve as 's officers and will be respon-

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(Footnote Continued)

> Commission on August 10, 1990. As you know, consistent with our prior practice, the positions we are taking below are effective as of the date of this letter.

sible for the daily activities of the CTA. also has support staff trained to take over in emergencies. None of 's principals will serve as 's officers or will be involved in day-to-day operations. Moreover, written "Chinese wall" procedures have been put in place to prevent knowledge of trading positions of being gained by 's trading staff and vice versa. 3/ Finally, you note that by letter dated July 24, 1990, the Commission's Division of Economic Analysis advised and that it would not recommend enforcement action to the Commission pursuant to Section 4a(1) of the Commodity Exchange Act (the "Act"), 7 U.S.C. §6a(1) (1988), to the extent that the CTAs together may maintain maximum net positions of twice the speculative position limits contained in Rule 150.2 outside of the spot month. This decision was based on the representations of the two CTAs that they were operated as independent, separately registered entities, with independently developed and operated trading systems, and that they were not, and would not be, involved in one another's trading activities. 4/

It is clear that , as a contributor of 90 percent of 's capital, is a principal of . Thus, absent an exemption, 's past performance would be required to be disclosed in 's Disclosure Document pursuant to Rule 4.31(a)(3). is not a principal of . However, we believe, and you concur, that inasmuch as has contributed 90 percent of 's capital, would be required to disclose 's past performance in its ('s) Disclosure Document pursuant to Rule 4.31(g). This position ensures that a CTA cannot avoid its disclosure obligations by creating subsidiary CTAs through which the parent CTA conducts some or all of its operations.

Based upon the representations you have made to us, we believe your request for relief from Rule 4.31(a)(3) has merit. This relief is based upon, among others, your representations that: (1) the and trading programs were separately developed; (2) and its personnel have no role in the day-to-day operations of ; (3) has sufficient support personnel such that, in the event of an emergency, it would not be necessary to call upon personnel for assistance; and (4) 's Disclosure Document explicitly states

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3/ Attached to your letter were memoranda detailing these procedures and affidavits from each CTA attesting that their respective traders will not acquire information on the trading of the other.

4/ These memoranda and affidavits also were filed in connection with the CTAs' request for relief from Section 4a(1).

that neither nor its principals have any involvement in 's trading. Accordingly, pursuant to the authority delegated by Rule 140.93(a)(1), is hereby exempted from the requirement in Rule 4.31(a)(3) that it include 's past performance in its ('s) Disclosure Document. This exemption is, however, subject to the condition that may not be marketed to the public in any way as a product or as a part of a "family" of products.

Based upon your representations, we further will not recommend that the Commission take any enforcement action against for failure to include 's past performance in its ('s) Disclosure Document. This position is, however, subject to the conditions that include in its Disclosure Document (1) the Participation Statement and (2) the Relief Statement, revised, of course, to make clear that relief from disclosing 's past performance has been received by .

You also have asked that we provide relief from Rule 4.21(a)(5) to and . However, and as is stated above, Rule 4.21(a)(5) applies to CPOs. and are registered as CTAs. Accordingly, Rule 4.21(a)(5) is not directly applicable to and but, rather, to a CPO who intends to have either or serve as the CTA of its pool. Inasmuch as the information required by Rule 4.21(a)(5) is virtually identical to the information required by Rule 4.31(a)(3), the Division will not recommend that the Commission take enforcement action against a CPO for failure to include in the Disclosure Document for the CPO's pool (1) 's past performance where will serve as the pool's CTA, or (2) 's past performance where will serve as the pool's CTA. This position is, however, subject to the conditions that (1) the CPO include in the Disclosure Document the Participation and Relief Statements, revised, as noted above, where is the CTA and (2) where will serve as the CTA, the CPO does not market the pool as a fund or as a member of the "family" of funds.

With respect to your request concerning Rule 1.46(d)(6)(i), based upon the representations you have made to us, it appears that and will be operated as independent entities with independent trading systems and they will not be involved in one another's trading activities. Accordingly, we confirm that where and each direct trading for a separate account of a client, they will satisfy the criteria of the rule that "each person directing trading for one of the separate ac-

counts is unaffiliated with and acts independently from each other person directing trading for a separate account." 5/

The positions taken in this letter do not excuse or from compliance with any other applicable requirements contained in the Act or in the Commission's regulations thereunder. For example, each remains subject to the anti-fraud provisions of Section 4o of the Act, 7 U.S.C. 6o (1988), to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the regulations and to all other provisions of Part 4.

In addition, as is noted above, in its Disclosure Document as filed with the Commission on April 1, 1990, rather than disclosing the past performance information required by Rule 4.31(a)(3), represents that the exemption from that requirement which is the subject of this letter has already been obtained. In this regard, you should specifically be aware that the positions taken in this letter do not preclude the Commission from taking enforcement or other action against or any other person involved in this apparent violation.

The positions taken in this letter are based upon the representations you have made to us and are subject to compliance with certain conditions set forth above. Any different, changed or omitted facts or conditions might require us to reach a different conclusion. In this regard, we request that you notify us immediately in the event that the operations of or change in any way from those represented above. Further, the "no-action" positions taken herein represent the views of the Division of Trading and Markets only. They do not necessarily reflect the views of the Commission or any other office or division of the Commission.

Very truly yours,

Susan C. Ervin

Susan C. Ervin
Chief Counsel

5/ In its July 24, 1990 letter, DEA based relief from Section 4a(1) of the Act on a finding that and were "independent" as defined in Rule 150.3, which provides relief from Section 4a(1) for certain CPOs.