



DIVISION OF
TRADING AND MARKETS

COMMODITY FUTURES TRADING COMMISSION

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91-6

June 13, 1991

Re:

Dear :

This is in response to your letter dated November 29, 1990, as supplemented by telephone conversations with Division staff, wherein you seek confirmation of your views concerning the availability of Rule 4.12(b) and the commodity pool operator ("CPO") and associated person ("AP") registration requirements applicable in connection with the operation of (the "Partnership").

Based upon the representations made in your letter, as supplemented, we understand the facts to be as follows. The Partnership was formed on December 19, 1986. Its sole general partner is , a general partnership whose general partners are and , none of whom is subject to a statutory disqualification under Section 8a(2) or 8a(3) of the Commodity Exchange Act (the "Act"), 7 U.S.C. §12a(2) or 12a(3) (1988). The Partnership has 40 limited partners and a current capitalization of \$59,900,000. Interests in the partnership have been offered and sold in private placement transactions exempt from the registration requirements of the Securities Act of 1933.

With respect to the Partnership's overall trading, your letter represents that:

The Partnership's objective is to achieve above-average capital appreciation by investing in securities. The Partnership utilizes a "multi-style, multi-manager diversification" philosophy of investment and operates as a "fund of funds". Assets of the Partnership are . . . invested in mutual funds (which trade solely in securities) and private limited partnerships ("Portfolio Partnerships") and with investment managers ("Portfolio Managers") pursuant to investment advisory agreements ("Advisory Accounts").

The principal purpose of each Portfolio Partnership, and the authority of each Portfolio Manager, is to invest and trade in securities.

The Partnership now seeks to engage in commodity interest trading by allocating its capital to: (1) investments in commodity pools for which a claim of exemption has been filed under Rule 4.12(b) ^{1/} ("Rule 4.12(b) pools"); (2) investments under the management of Portfolio Managers contractually bound to a ten percent limitation on the amount of the fair market value of the Partnership's assets that may be used to establish commodity interest trading positions; and (3) limited direct trading of S&P 500 futures contracts. By your letter you request confirmation that the Partnership itself will be able to claim relief under Rule 4.12(b) provided that the sum of (1), when multiplied by ten percent as is discussed more fully below, (2), when multiplied by such ten percent, and (3) will not exceed ten percent of the fair market value of the Partnership's assets.

As you know, Rule 4.12(b) provides certain "substituted compliance" relief from Rules 4.21, 4.22 and 4.23(a)(10) and (a)(11) for the CPO of a commodity pool which, among other things --

will not enter into commodity futures and commodity options contracts for which the aggregate initial margin and premiums exceed 10 percent of the fair market value of the pool's assets, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into; Provided, however, That in the case of an option that is in-the-money at the time of purchase, the in-the-money amount as defined in §190.01(x) may be excluded in computing such 10 percent. ^{2/}

^{1/} Commission rules referred to herein are found at 17 C.F.R. Ch. I (1990).

^{2/} Rule 4.12(b)(2)(i)(C). The rule also requires the pool to be offered and sold pursuant to the Securities Act of 1933 or pursuant to an exemption therefrom; to be generally and routinely engaged in the buying and selling of securities and securities derived instruments; and to trade commodity interests in a manner solely incidental to its securities trading activities. Rules 4.12(b)(2)(i)(A), (B) and (D), respectively.

For the purpose of this letter, this requirement is referred to as the "Initial Margin Test."

In support of your request you note that the Initial Margin Test is drafted in terms of the percentage of assets which may be committed to initial margin and option premiums, and that neither the Test nor any other provision of Rule 4.12(b) distinguishes between direct investments in commodity interests and indirect investments made through an intermediary -- e.g., a Rule 4.12(b) pool. In further support of your request you state:

Ignoring the regulatory and contractual restrictions on the Portfolio Partnerships and Portfolio Managers, respectively, would put the Partnership in an anomalous and illogical position. For example, if the Partnership's only involvement with commodity transactions was an investment of 11% of the Partnership's assets in a 4.12(b) Pool, the Partnership, having only 1.1% of its assets available for deposit as initial margin, would not be able to avail itself of the relief afforded by Section 4.12(b). In contrast, if the Partnership made a 1.1% commitment to commodity trading directly, the relief provided by Section 4.12(b) would be available to the Partnership. In addition, the Partnership, by investing 11% of its assets in a 4.12(b) Pool, would be required to adhere to more rigorous disclosure and reporting requirements than the 4.12(b) Pool in which it invested, even though the 4.12(b) Pool could have a much greater percentage of its assets committed as initial margin (10% vs. 1.1%) than the Partnership. Neither the Act nor the Rules contemplate such disparate treatment.

In response, the Division notes that neither Rule 4.12(b) as proposed nor as adopted ^{3/} contemplated the circumstances of the instant case and that none of the commenters on the proposed rule referred to these circumstances. However, the Division is of the view that it would not be inconsistent with the purpose of Rule 4.12(b) to address indirect investments through the vehicle of Rule 4.12(b) pools in the manner suggested. Accordingly, the

^{3/} See 52 Fed. Reg. 19522 (May 26, 1987) and 52 Fed. Reg. 41975 (November 2, 1987), respectively.

Division interprets Rule 4.12(b) such that for the purpose of meeting the Initial Margin Test, where a pool for which relief is being sought under Rule 4.12(b) intends to trade commodity interests through investing in a (previously qualified) Rule 4.12(b) pool, then the (investing) pool may multiply its intended investment by ten percent and add that amount to whatever other commodity interest trading investments it intends to make (e.g., directly or indirectly under Rule 4.12(b)) in determining whether the Initial Margin Test will be met.

With respect to the instant case, this means that to determine whether it will meet the Initial Margin Test, the Partnership may use the sum of its capital allocated to: (1) investments in (other) Rule 4.12(b) pools, multiplied by ten percent; (2) investments under management by Portfolio Managers contractually bound to a ten percent limitation on the amount of the fair market value of the Partnership's assets that may be used to establish the Partnership's commodity interest trading positions, multiplied by ten percent; and (3) direct trading of commodity interests. ^{4/}

As noted above, you also request confirmation of your views concerning the CPO and AP registration requirements applicable in connection with the Partnership's operation. Specifically, in connection with the Partnership's trading of commodity interests, the Partnership proposes to admit

, a registered CPO, to serve together with , as a co-general partner, of the Partnership and as the registered CPO of the Partnership. It also proposes that ^{5/} and , two of 's three individual general partners, will register as APs of . , the third of the individual general partners, will not register as an AP of . ^{6/} The Partnership's choice of Portfolio Partnerships and Portfolio Managers, as well as trading decisions relating to S&P 500 futures contracts, will be made under the supervision of and in his capacity as a principal and AP of . will not solicit for the Partnership, will not provide commodity

^{4/} Of course, and as you acknowledge, to qualify for relief under Rule 4.12(b) both the Partnership and its CPO must meet all of the other criteria set forth in the rule.

^{5/} Commission records indicate that currently is listed as a principal of .

^{6/} serves on the Board of Directors of several public and private companies and is a Senior Advisor to

interest trading advice to the Partnership and will not engage in any commodity interest-related activities with respect to the Partnership or any other person. While _____ and _____ will solicit investors in the Partnership,

_____ will not engage in the solicitation of funds for investment in the Partnership. _____ may from time to time refer names of potential investors in the Partnership to _____ and _____, who, in their discretion, may contact such person to discuss the possibility of investment in the Partnership. Any compensation received by _____ will not vary depending upon, or otherwise be linked to, the outcome of such referrals.

Further, _____ will not provide commodity interest trading advice to the Partnership nor will he engage in any commodity interest-related activities with respect to the Partnership or any other person.

As you note, the Division previously has issued registration "no-action" relief such that fewer than all of the general partners of a limited partnership operated as a Rule 4.12(b) pool were required to register as a CPO. ^{7/} In the instant case, _____ and _____, as registered APs, will have undergone the same fitness and qualifications exams as those required of applicants for CPO registration. As you also note, the Division has stated that registration as an AP of a CPO is required of a person who introduces a potential investor to a CPO and who is compensated as a "finder" ^{8/} -- i.e., _____ and _____ but not _____.

Accordingly, based upon the representations you have made to us, the Division will not recommend that the Commission take any enforcement action (1) under Section 4m(1) of the Act, 7 U.S.C §6m(1) (1988), for failure to register as a CPO against _____, _____ or _____, or (2) under Section 4k(2) of the Act,

^{7/} See, e.g., Division of Trading and Markets Interpretative Letter No. 86-30, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,415 (December 11, 1986).

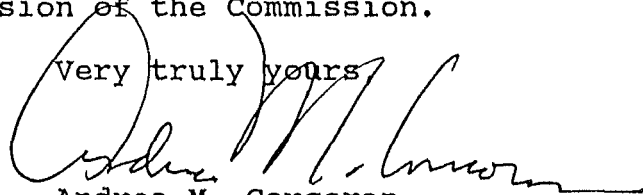
^{8/} Division of Trading and Markets Interpretative Letter No. 90-4, [1987-90 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,588 (January 13, 1990).

7 U.S.C. §6k(2) (1988), for failure to register as an AP of a CPO against . This position is, however, subject to the condition that file a Form 8-R and fingerprint card with the National Futures Association.

We note that this letter does not excuse any person subject hereto 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), and to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's regulations. Moreover, the positions which we have taken herein are solely applicable in connection with the operation of the Partnership.

The views expressed in this letter are based upon the representations that have been made to us and are subject to strict compliance therewith and with respect to the registration no-action position issued to , to compliance with the condition stated above. Any different, changed or omitted facts or conditions might require us to reach a different conclusion. In this connection, we request that you notify us immediately in the event that the operations of the Partnership change in any way from those as represented to us. Further, this letter represents the position of the Division of Trading and Markets only. It does not necessarily represent the views of the Commission or any other office or division of the Commission.

Very truly yours,



Andrea M. Corcoran
Director