



COMMODITY FUTURES
TRADING COMMISSION
RECEIVED FOR
PUBLIC RECORD
2033 K Street, NW, Washington, DC 20581
(202) 254 - 8955
(202) 254 - 8010 Facsimile
JAN 4 11 36 AM '85

95-01
~~95-01~~

DIVISION OF
TRADING AND MARKETS

December 12, 1994

Re: Rule 4.31(a)(3)(i) — Request by a Commodity Trading Advisor ("CTA") for Relief from Disclosing Past Performance of Pools Operated by a Commodity Pool Operator ("CPO") Where Principal of CPO Is To Become a Principal of the CTA

Dear :

This is in response to your letter dated September 28, 1994, as supplemented by telephone conversations with Division staff, in which you request relief from Rule 4.31(a)(3)(i)^{1/} in connection with the Disclosure Document of "X". Specifically, "A", currently executive vice president and a 50% shareholder of "Y", intends to become an executive vice president and principal of "X", and "X" seeks exemption from disclosing the past performance of pools operated by "Y".

Based upon the representations made in your letter, as supplemented, we understand the relevant facts to be as follows. "X" is registered as a CPO and a CTA, and it has been trading since 1988. "X" presently has approximately 40 accounts with total assets of approximately \$133 million. At the present time, "X" has two principals, you and "A's" wife. You represent that "A" is already employed by "X", performing certain of "X's" accounting and marketing functions, but not acting in an executive capacity. "X" now intends to make "A" an executive vice president and to increase his overall involvement in "X". You emphasize that "A's" duties with "X" have not included and will not include responsibility, whether directly or indirectly, for any aspect of "X's" trading or the supervision thereof, including without limitation, selecting or recommending CTAs.

In addition to working for "X", "A" is also a principal of "Y" (as an officer and 50% shareholder), although you represent that he has not been involved in the management or day-to-day operations of "Y" since April, 1991, approximately the same time he was hired by

^{1/} Commission rules referred to herein are found at 17 C.F.R. Ch. I (1994).

"X". You further represent that if "A" becomes a principal of "X", he will resign as executive vice president of "Y". "A" would, however, retain his 50% ownership interest in "Y".

"Y" operates two commodity pools (the "Pools"). For one of the Pools, "X" is one of three CTAs, and for the other, "X" is one of two CTAs. You represent that the CTAs for the Pools were initially selected by "A", and that with one minor exception, no changes have ever been made from the original selections. You further represent that all such selections by "A" were made prior to April 1991.

You claim that if "A" becomes a principal of "X", Rule 4.31(a)(3)(i) should not require "X" to disclose the past performance of the Pools for the following reasons: (1) although he selected the CTAs which initially and currently advise the Pools, he did not "direct" any accounts within the meaning of Rule 4.10(f); (2) "A" will not be involved in any of the trading decisions of "X", and therefore any past performance information regarding him is of questionable relevance to "X's" clients; and (3) even if "A's" activities with respect to selecting CTAs for the Pools constituted directing accounts, the track records of the Pools are not relevant to "X's" clients because "X's" activities relate to the direct management of client accounts, not the selecting of CTAs^{2/} (and thus are unrelated to "A's" activities at "Y").

You note, however, that although the past performance of each of the Pools as a whole is not shown in "X's" Disclosure Document, the performance of "X" as an advisor trading a portion of the assets of each of the Pools is currently included in "X's" composite performance table.

Rule 4.31(a)(3)(i) requires a CTA to disclose "... the actual performance for the three years preceding the date of the Document of all accounts directed by the commodity trading advisor and by each of its principals ...". The Division has consistently taken the position that with respect to a principal who has had authority to select, hire and fire CTAs for a commodity pool the performance disclosure required by Rule 4.31(a)(3)(i) is that of the accounts traded by the CTAs who were selected by such principal. "A" served as such a principal. Although you represent that since April 1991, "A" has not been involved in "Y's" trading activities, you also represent that with one minor exception, no changes have been made subsequent to "A's" original CTA selections. Accordingly, if "A" becomes a principal of "X", absent relief "X" would be required

^{2/} You note that "X" acts as CTA for the only commodity pool it operates, and that "X" does not select other CTAs for that pool.

under Rule 4.31(a)(3)(i) to disclose the complete past performance of the Pools for the preceding three years.

The Commission has published for comment proposed revisions to its Part 4 CPO/CTA disclosure regulations^{3/} (the "Proposed Revisions"). Pursuant to the Proposed Revisions, the CTA principals for whom past performance is to be disclosed are limited to "trading principals."^{4/} A trading principal is defined as "[a] principal of a commodity trading advisor who participates in making commodity interest trading decisions for a client account or who supervises or selects persons so engaged."^{5/} Your letter, as supplemented, states that as a principal of "X", "A" will not be involved in the trading decisions of "X" and that his duties have not and will not include responsibility for supervising or conducting any aspect of "X's" trading, or selecting persons so engaged. Accordingly, with respect to "X", "A" would not be a "trading principal" and under the Proposed Revisions, "X" would not be required to include the past performance of the Pools as a whole in its disclosure document by reason of "A's" principal status.

Based upon the representations in your letter as supplemented, (and in view of the fact that "X" already includes in its composite performance table its trading results as a CTA of each of the Pools), we concur that "X" should not be required to separately present the past performance of the Pools. Accordingly, the Division will not recommend that the Commission take any enforcement action against "X" if "X" fails to include in its CTA Disclosure Document the complete past performance of the Pools as a whole (as distinguished from the performance of "X's" allocated portion of the assets of the Pools, which "X" should continue to include). This position is, however, subject to the condition that "X" complies with the provisions of Part 4 as they may be amended pursuant to final action by the Commission with respect to the pending rulemaking as set forth in the Proposed Revisions, which shall supersede the no-action relief granted herein.^{6/}

^{3/} The proposed revisions were published at 59 Fed. Reg. 25351 (May 16, 1994).

^{4/} Proposed Revisions, Rule 4.34(b), 59 Fed. Reg. at 25375.

^{5/} Proposed Revisions, Rule 4.10(m)(2), 59 Fed. Reg. at 25368.

^{6/} These requirements include the duty to disclose all material information to existing or prospective pool participants even if the information is not specifically required by Commission rules. See Rule 4.21(h).

You should be aware that the no-action position taken by this letter will not excuse "X" from compliance with any otherwise applicable requirements contained in the Commodity Exchange Act (the "Act")^{7/} or in the Commission's regulations thereunder. For example, "X" will continue to be subject to Section 4^{8/} of the Act and to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's regulations.

This letter is based on the representations provided to us and is subject to the conditions set forth above. Any different, changed or omitted facts or circumstances might require us to reach a different conclusion. In this connection, we request that you notify us immediately in the event that the activities and responsibilities of "A", or the activities and operations of "X" change in any way from the descriptions contained in your letter as supplemented. If you have any questions concerning this correspondence, please contact me or Christopher W. Cummings, an attorney on my staff, at (202) 254-8955.

Very truly yours,

Susan C. Ervin
Chief Counsel

^{7/} 7 U.S.C. §1, et seq. (1988 & Supp. IV 1992).

^{8/} 7 U.S.C. §6⁰ (1982).