



COMMODITY FUTURES TRADING COMMISSION

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95-53

DIVISION OF
TRADING AND MARKETS

March 13, 1995

Re: Request for Relief from Rules 4.21(a)(4), 4.21(a)(5)
and 4.21(f)

Dear :

This is in response to your letter dated October 6, 1994 to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by letter dated January 27, 1995 from you and by letters dated December 2, 1994, December 27, 1994, January 5, 1995, January 31, 1995 and February 22, 1995, from "A", and telephone conversations among you, "A" and Division staff, wherein you request on behalf of "X", a registered commodity pool operator ("CPO"), certain relief from Commission Rules 4.21(a)(4), 4.21(a)(5) and 4.21(f) in connection with "X's" operation of the (the "Trust").^{1/}

Based upon the representations made in your letter, as supplemented, we understand the pertinent facts to be as follows: "X" is the Managing Owner and CPO of the Trust, which has been formed as a business trust under the Delaware Business Trust Act (the "Delaware Act")^{2/} to offer commodity pool interests on an open-ended basis. The Trust intends to offer a series of different commodity pool portfolios (the "Portfolios"), each of which will be a "qualitatively different" managed futures investment. The first Portfolio so offered will be the "Classic Series."

You have represented that you are in the process of obtaining an opinion of counsel that specifically addresses the application of the Bankruptcy Code to the Trust, particularly with respect to whether the assets of one Portfolio would be subject to the claims of a bankruptcy trustee or any creditor in the

^{1/} By your January 27, 1995 letter, you withdrew your initial request for relief from Rule 4.21(a)(5) to permit exclusion of performance disclosures for advisors allocated less than ten percent of the Trust's assets for commodity interest trading. Commission rules referred to herein are found at 17 C.F.R. Ch. I (1994).

^{2/} 12 Del. C. § 3801 et seq.

event that another series became bankrupt. You represent that the Trust will not issue any Portfolio in addition to the first Portfolio until a satisfactory legal opinion as to the separate treatment of each Portfolio is received by us.

Request for Relief from Rule 4.21(a)(4).

Where a pool has not commenced trading commodity interests (as in the case of the Trust), Rule 4.21(a)(4)(i)(C) requires that the CPO prominently disclose that fact in the Pool's Disclosure Document and the performance of each other pool operated by the CPO and by each of its principals for the three years preceding the date of the Document.

One of "X's" principals, "B", was, until December 1992, the president of "Y", a registered CPO which operates approximately twenty-three commodity pools (the "Z" Pools"). You request relief from Rule 4.21(a)(4)(i)(C) such that "X" need not disclose the performance of the "Z" Pools in the Trust's Disclosure Document. In support of your request you note that "X" has a ten-year performance record as a CPO, which record will be disclosed in the Trust's Disclosure Document.^{3/} You further note that as part of its proposed amendments to the disclosure rules for CPOs and commodity trading advisors ("CTAs") (the "Proposed Revisions")^{4/}, the Commission has proposed to revise its past performance rules for CPOs such that where the pool offered has no performance history, the CPO must: (1) prominently disclose that fact; (2) disclose, for the most recent five calendar years and year-to-date, or for its entire duration, the performance of each other pool operated by the CPO if the CPO has at least a three-year history in trading pools with no fewer than fifteen participants unaffiliated with the pool operator in which no more than ten percent of the assets were contributed by the CPO -- and only if it does not have such a history must the CPO disclose its principals' past performance; (3) the performance of any account (including pools) directed by any "major CTA" and of any "major" investee pool; and (4) indicate, for such period, any "adverse performance" for any account (including pools) directed or operated by, among other persons, the CPO and the CPO's trading principals.^{5/}

Given "X's" eight-year history as a CPO, under the proposed amendments of Part 4, the performance history of its principals

^{3/} Specifically, "X" has served as the CPO of "V" since 1984 and "W" since 1986.

^{4/} See generally 59 Fed. Reg. 25351 (May 16, 1994).

^{5/} Proposed Rule 4.25(c), 59 Fed. Reg. 25351, 25372-73.

would not be required to be disclosed except to the extent that any "adverse performance" (as defined in the proposed rules) of the CPO's trading principals would be required to be presented.

In support of your request, you note that during "B's" years at "Y", he played a limited role in the advisor selection and asset allocation process but took no part in the daily operations of the "Z" Pools. You represent that "B's" role in advisor selection at "X" is also limited and that his activities primarily relate to marketing. You propose to provide, in lieu of performance tables for the "Z" Pools or any "adverse performance" thereof, a textual discussion reflecting "B's" previous responsibilities at "Y", the nature of the trading results of the "Z" Pools, and a statement to the effect that full performance records for the "Z" Pools will be made available on request. Based upon the foregoing, and subject to the condition set forth below relating to amendments of the Commission's Part 4 rules, the Division will not recommend that the Commission take any enforcement action against "X" if it does not include the performance data for the "Z" pools relevant to "B" as a principal of "X" in the Trust's Disclosure Document.

Request for Relief from Rule 4.21(a)(5).

Rule 4.21(a)(5) requires a CPO to disclose the actual performance record of the pool's CTA and each of its principals in the format specified by the rule (the so-called "six-column format") or by a method otherwise approved by the Commission. You request relief from Rule 4.21(a)(5) with respect to presentation of the performance records for CTAs to whom "X" allocates more than ten percent but less than twenty-five percent of a Portfolio's assets for trading. In lieu of full compliance with the rule, you seek to have "X" present the past performance of any such CTA in the capsule format proposed by the Commission.^{6/} In support of this request you note that what you propose would provide for greater disclosure than the "adverse performance" concept contained in the Proposed Revisions for "ten to less than twenty-five percent" CTAs.

Based upon the foregoing, and subject to the conditions set forth below, the Division will not recommend that the Commission take any enforcement action against "X" for failure to comply with Rule 4.21(a)(5) if it presents in the Trust's Disclosure Document the past performance of a CTA to whom "X" has allocated more than ten percent but less than twenty-five percent of a Portfolio's assets for trading pursuant to the capsule format set forth in the Proposed Revisions.

^{6/} Proposed Rule 4.25(a)(1), 59 Fed. Reg. 25351, 25371-72.

The foregoing relief from Rule 4.21(a)(5) is subject to the conditions that: (1) the failure to disclose any of the foregoing information would not be materially misleading; and (2) "X" prominently disclose in the Trust's Disclosure Document the following legend:

PURSUANT TO AN EXEMPTION RECEIVED FROM THE COMMODITY FUTURES TRADING COMMISSION, THIS DISCLOSURE DOCUMENT IDENTIFIES AND INCLUDES SOME, BUT NOT ALL, OF THE INFORMATION OTHERWISE REQUIRED TO BE INCLUDED FOR EACH OF THIS POOL'S CTAS TO WHOM "X" HAS ALLOCATED LESS THAN TWENTY-FIVE PERCENT OF THIS POOL'S ASSETS FOR TRADING. "X" WILL PROVIDE YOU WITH A COPY OF ANY SUCH CTA DISCLOSURE DOCUMENT AT NO COST TO YOU WITHIN TEN DAYS FOLLOWING RECEIPT OF A WRITTEN REQUEST THEREFOR.

This relief also is subject to the condition set forth below relating to amendments to the Commission's Part 4 rules.

Request for Relief from Rule 4.21(f).

Rule 4.21(f) requires that the CPO attach to its pool's Disclosure Document the most current Account Statement for the pool.^{7/} In support of your request for relief from this rule, you explain that the Trust will be publicly offered through a large nationwide syndicate of registered securities broker-dealers. You contend that because the Trust will offer daily investment and redemption privileges it is impossible to comply with the requirements of Rule 4.21(f) but that the investor benefits resulting from daily liquidity significantly outweigh the benefits accruing from provision of the most recent Account Statement with the Disclosure Document. For example, you note that a monthly report printed on March 25 could not be provided to a subscriber investing on March 26, yet when the investor does receive the most recent monthly report, which in lieu of full compliance with Rule 4.21(f), you propose to be sent with the confirmation of purchase, he can elect to redeem his interest immediately. You also note that the monthly legal opinion delivered to the "X" sponsor will cover the material accuracy of the Disclosure Document at each daily closing date and that "X" will not solicit with a Disclosure Document that is materially inaccurate in any respect unless it is supplemented to cure any

^{7/} Rule 4.21(f) also requires the CPO to attach the pool's most recent Annual Report to the Document. You have not requested, and by this letter we are not providing, any relief from that requirement.

such defect and the supplement is given at the time of solicitation.^{8/}

We note that we have previously issued relief from the Account Statement delivery requirement of Rule 4.21(f) where, like the instant case, a CPO intended to employ multiple broker-dealers to sell units of participation in its pool.^{9/} That relief was, however, subject to the condition that within a short period of time following receipt of a pool subscription, the CPO would send the Account Statement with the confirmation statement to the participant and the participant would have a "free look" period following receipt thereof to determine whether to maintain or cancel its initial subscription.^{10/} In the instant case, you claim that because of the Trust's daily investment and redemption provisions, a requirement to adopt a similar "free look" period would be unworkable because daily calculation of a net asset value would not be possible if participants were accorded the right to redeem their interests at their entry price. However, in this context, in contrast to the vast majority of commodity pools, investors will have the benefit of the availability of daily net asset values and daily redemption.

Based upon the foregoing, the Division will not recommend that the Commission take any enforcement action against "X" for failure to comply with Rule 4.21(f) if it does not deliver an Account Statement with the Trust's Disclosure Document but, rather, provides the most recent Account Statement with the confirmation of purchase, as discussed in your correspondence with the Division.

* * * *

This letter is based upon the representations that have been made to us. It is subject to compliance with the conditions set forth above and to the provisions of Part 4 as they may be amended pursuant to final action by the Commission with respect

^{8/} Supplementation would occur, for example, if the most recent performance data were materially different from that contained in the Disclosure Document. You represent that performance will be monitored on a daily basis to ensure that the Document has not become misleading with respect to performance data.

^{9/} See, e.g., CFTC Interpretative Letter No. 92-13, [1990-92 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,370 (August 25, 1992).

^{10/} The time periods of and disclosures required in connection with the "free look" are set forth more fully in the Division's relief letters.

to the Proposed Revisions, which shall supersede the relief granted herein. 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 the operations or activities of "X" change in any way from those as represented to us.

We note that this letter relieves "X" solely from certain requirements of Rules 4.21 as set forth above in connection with the operation of the Trust and does not excuse it from compliance with any other applicable requirements contained in the Commodity Exchange Act, 7 U.S.C. § 1 et seq. (1988 & Supp. V 1993) ("Act"), or the Commission's regulations issued thereunder. For example, "X" remains subject to the antifraud 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 Commission's regulations, and to all other provisions of Part 4.

If you have any questions concerning this correspondence, please contact me or Barbara Stern Gold, Assistant Chief Counsel, at (202) 254-8955.

Very truly yours,

Susan C. Ervin
Chief Counsel