U.S. COMMODITY FUTURES TRADING COMMISSION
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DIVISION OF
TRADING & MARKETS

96-22

March 5, 1996

Re: Rule 4.20(c) -- Request for relief from prohibition against commingling of pool funds, in order to permit a commodity pool operator ("CPO") to aggregate assets of existing pools meeting certain criteria into one or more general partnerships to enable such pools to access commodity trading advisors ("CTAs") that would be otherwise unavailable

Dear :

This is in response to your letter dated October 12, 1995 to the Division of Trading and Markets (the "Division") of the Commodity Futures Trading Commission (the "Commission"), as supplemented by your letters dated October 31, 1995, November 2, 1995, December 28, 1995, January 24, 1996, February 26, 1996 and February 28, 1996, by letters dated October 17, 1995 from "A", president of "U", and dated October 19, 1995 and January 30, 1996 from "B", "U"'s director of compliance, and by meetings and telephone conversations with Division staff.[1/] By your letters, as supplemented, you request on behalf of "U" that the Division grant to "U", on a limited "pilot program" basis, an exemption from the prohibition set forth in Commission Rule 4.20(c)[2/] against commingling the property of any pool that a CPO operates with the property of any other person. You have requested this relief in order that "U" may form general partnerships ("Account Partnerships"), the partners of which would be certain existing commodity pools (the "Pools") of which "U" is the CPO, and for all but one of which "U" claims that the respective net asset values have declined

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1/ You enclosed for consideration with your October 12, 1995 letter copies of your prior letters to the Division dated September 9, 1994 and October 17, 1994.

2/ Commission rules referred to herein are found at 17 C.F.R. Ch. I Part 4 (1995), as amended by 60 Fed. Reg. 38146 (July 25, 1995).

to a level that is insufficient to permit them access to more than a very limited selection of CTAs.[3/]

Based upon the representations made in your correspondence, we understand the relevant facts to be as follows. "U", a registered CPO and CTA, operates approximately twenty-three pools. A substantial number of those pools have been in operation for more than five years. Certain of these pools formed five or more years ago (the Pools as defined herein) have experienced a significant decline in asset value over a number of years. You claim that, as a result, the Pools cannot engage many of the more successful CTAs (who require that new accounts exceed a specified minimum net equity) or achieve desired diversification. "U" believes that a mechanism by which assets of two or more of the Pools could be combined would overcome the obstacle of minimum account size requirements and would permit at least some of the Pools to access more than one trading program.

"U" has determined, subject to receipt of the requested exemptive relief, to employ a general partnership structure to aggregate pool assets. A separate "Account Partnership" will be formed for each CTA that "U" selects to trade assets for the Pools. If "U" decides to access more than one trading program offered by the same CTA, it will form a separate Account Partnership for each such program. With the exception of the Fund, all of the assets of each of the Pools will be invested in one or more of the Account Partnerships.[4/]

"U" will determine the mix of Pools in each Account Partnership on the basis of the stated investment and trading policies of the respective Pools. An Account Partnership will not necessarily include all of the Pools. Each Account Partnership will be governed by a separate general partnership agreement. Each Pool in an Account Partnership will participate pro rata in profits and losses based on each Pool's pro rata contribution of capital to the Account Partnership. Each Pool's capital account in an Account Partnership will be fully funded, and no notional equity will be permitted in any Account Partnership.

3/ The exception is the Fund, with net assets as of September 30, 1995 of $15,136,699. "U" intends that without the Fund's assets, the proposed structure outlined in your letter, as supplemented, cannot achieve sufficient diversification among CTAs.

4/ We express no opinion whether investment of a Pool's assets in such Account Partnerships would bring such Pool within the "investment company" definition of the Investment Company Act of 1940, 15 U.S.C. § 80a-1 et seq. (1994).

Full disclosure of the new structure will be made to each participant in the Pools at least thirty days in advance of the formation of the Account Partnerships. Each Pool participant will be permitted to redeem his investment without penalty, prior to "U's" implementation of the new structure. You represent that the Account Partnership structure is not a device to circumvent the individual Pools' provisions in their partnership agreements regarding limitation on losses (so-called "blow-out" provisions) and that in all respects each pool will be accounted for separately.

You represent that "U" will not receive any additional compensation as a result of the organization, capitalization or operation of the Account Partnerships. You further represent that "U" will close out the Pools' existing positions and transfer Pool assets (but not open positions, all of which must be liquidated and reopened at the Account Partnership level) to the Account Partnerships without cost to the Pool participants and without changing the fee structure and method of calculation for any Pool. No fees or expenses not already disclosed in their respective Disclosure Documents will be charged to the Pools. "U" will agree to indemnify each Pool for all expenses the Pool would not have incurred but for its participation in an Account Partnership.

Each component Pool's share of an Account Partnership's liabilities will be pro rata, based upon the assets contributed by such Pool. Each Pool will explicitly agree to contribute to each other Pool such amounts as may be necessary to effect a pro rata division of all losses.

You represent that "U's" proposal does not violate any applicable statute or regulation administered by the Securities and Exchange Commission or any State securities regulatory body. This letter does not address "U's" compliance or non-compliance with such statutes or regulations.

Based upon compliance with the conditions set forth below, the Division will not recommend that the Commission take any enforcement action against "U" for failure to comply with Rule 4.20(c) in connection with the investment of the Pools' assets in the Account Partnerships, as described above.

1. "U" observes the following eligibility standards for pools participating in any Account Partnership, which pools will be limited to those set forth on the list attached to this letter as Exhibit A:

(a) Only pools of which "U" is, and of which "U", "V" or "W" has at all times been, the sole CPO and general partner may participate in any of the Account Partnerships;

(b) Only pools operated in the United States that have been in continuous operation for five or more years as of the date of this letter may participate in any of the Account Partnerships (the sole exception being "X" and "Y", which has been in operation for approximately two-and-one-half years);

(c) With the exception of the Fund, only pools for which the net asset value is less than $6,000,000 at the time of an Account Partnership's formation may participate in such Account Partnership;

(d) Only qualifying pools may participate in an Account Partnership, and no third party, including "U" acting for its own account (as distinguished from "U" acting as CPO of a Pool), may contribute capital to, or share in the profits and losses of, any of the Account Partnerships; and

(e) Any pool may withdraw from an Account Partnership at any time.

2. "U" observes the following requirements with respect to the operation of each Account Partnership:

(a) Each Account Partnership will be governed by a separate general partnership agreement;

(b) Each Account Partnership's partnership agreement will provide that each participating Pool will share in the Account Partnership's profits and losses pro rata, based upon the dollar amount of assets contributed by such Pool;

(c) Each participant in each Pool participating in an Account Partnership will be notified in writing at least thirty days prior to such Pool's purchase of its partnership interest, and such participant will be offered the opportunity to redeem his/her interest in such Pool prior to such purchase;

(d) Each Account Partnership will trade through a single trading program of a single CTA. In no event will the assets of a Pool in an Account Partnership be traded at

a degree of leverage different from that applicable to any other Pool in the same Account Partnership;

(e) The aggregate assets of the Pools participating in an Account Partnership will be traded as a single account and individual futures contracts, options or other instruments will not be specifically allocated to any Pool;

(f) All futures and futures option trades on behalf of any Account Partnership will be cleared through "U's" affiliate, "Z", a registered futures commission merchant;

(g) The value of the capital accounts of each of the Pools participating in any Account Partnership will be calculated daily, and the aggregate of such valuations will be compared to the value of the Account Partnership's account with "Z", with any discrepancy to be resolved in favor of the affected Pool(s);

(h) Each Account Partnership's partnership agreement will expressly require that the term of the Account Partnership end immediately at any time that the Account Partnership's cumulative returns as of the close of business on any trading day represent a loss of fifty percent or more from the time of formation of the Account Partnership;

(i) "U" agrees in writing to indemnify each Pool against any and all losses to such Pool resulting from any failure by "U", whether due to negligence or otherwise, to operate the Account Partnerships as contemplated by the terms of their respective partnership agreements and as described in your letter, as supplemented; and

(j) Promptly upon the organization of each Account Partnership, "U" will inform the Division in writing of the name of the Account Partnership and the CTA advising it, and "U" will promptly notify the Division of any change in such information.

3. "U" will maintain at all times net capital in an amount greater than or equal to ten percent of the aggregate net assets of all of the Pools participating in the Account Partnership structure.

4. "U" observes the following requirements with respect to accounting and reporting:

(a) Each Account Partnership will provide each of its participating Pools monthly account statements, quarterly unaudited financial statements, and annual reports (such annual reports to include at a minimum the audited financial statements required for commodity pool annual reports by Rule 4.22(c)); and

(b) "U" will instruct its independent public accountants to conduct a "surprise audit" (in the manner contemplated by Rule 206(4)-2(a)(5)[5/] under the Investment Advisers Act of 1940[6/]) of each Account Partnership at least twice during each fiscal year of such Account Partnership at a time that is chosen by such accountants without prior notice to "U" or to such Account Partnership for the purpose of confirming compliance with the conditions set forth herein. "U" will bear the cost of such "surprise audits."

5. "Z" agrees in writing with "U" prior to commencement of trading for any Account Partnership (and provides the Division with a copy of such written agreement within thirty days of the date of this letter) that in the event of a deficit in the account of any Account Partnership, "Z" will seek to collect such deficit as follows:

(a) "Z" will collect such deficit from the Pools comprising the Account Partnership, pro rata, according to their respective participations in such Account Partnership; and

(b) To the extent that a deficit is not satisfied by efforts to collect from the Pools on a pro rata basis as specified in subparagraph 5(a), "Z" will seek to collect the balance of such deficit from "U", before attempting to collect from any of the Pools comprising the Account Partnership any amount in excess of such Pool's pro rata share of such deficit according to such Pool's participation in such Account Partnership.

This position is taken on a "pilot program" basis for a period of one year from the date of this letter, and is applicable only with respect to those Pools listed on Exhibit A attached hereto.

5/ 17 C.F.R. §275.206(4)-2(a)(5) (1995).

6/ 15 U.S.C. § 80b-1 et seq. (1994).

At the end of such one-year period the Division will consider extending the relief hereby granted.

This letter is based upon the representations provided to us. 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 "U", the Pools, "Z" or any of the Account Partnerships change in any way from those represented to us. Further, this letter is applicable to "U" solely in connection with its operation of the Pools and the Account Partnerships.

We note that this letter relieves "U" solely from the requirements of Rule 4.20(c), and does not excuse it from compliance with any other applicable requirements contained in the Commodity Exchange Act (the "Act")[7/] or in the Commission's regulations issued thereunder. For example, "U" remains subject to the antifraud provisions of Section 4o of the Act[8/] to the reporting requirement 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 Christopher W. Cummings, an attorney on my staff, at (202) 418-5445.

Very truly yours,

Susan C. Ervin
Chief Counsel

7/ 7 U.S.C. §1 et seq. (1994).

8/ 7 U.S.C. §6o (1994).