



U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5430
Facsimile: (202) 418-5536

DIVISION OF
TRADING & MARKETS

April 12, 1996

Re: Request for Relief Permitting a Registered Commodity Pool Operator ("CPO") and Sole General Partner of a Market-Maker on the Chicago Board Options Exchange ("CBOE") To Use Standard & Poor's 500 Stock Index ("SPX") Futures To Hedge Such Market-Making Activities without Complying with the Disclosure, Reporting and Recordkeeping Requirements of Commission Rules 4.21 through 4.26

Dear :

This is in response to your letter dated February 9, 1996 to the Division of Trading and Markets (the "Division") of the Commodity Futures Trading Commission (the "Commission"), as supplemented by your letters dated February 26 and February 29, 1996, your memorandum dated March 11, 1996 and by telephone conversations with Division staff. By your correspondence, you request on behalf of "A", the general partner of limited Partnership, an Illinois limited partnership "U", relief permitting "A" to use SPX futures to hedge temporary portfolio imbalances in the course of "U's" activities as a market-maker on the CBOE, without complying with the disclosure, reporting and recordkeeping requirements of Commission Rules 4.21 through 4.26.^{1/} You also request relief from the requirement to register as a CPO on behalf of "V" the sole general partner of "W", in connection with "W's" limited partnership interest in "U".^{2/}

^{1/} Commission rules referred to herein are found at 17 C.F.R. Ch. I (1995), as amended by 60 Fed. Reg. 38146 (July 25, 1995, effective August 24, 1995).

^{2/} Absent such relief for "V", "U's" use of SPX futures and "W's" resulting commodity pool status would require "V" to register as a CPO.

Based upon the representations made in your February 9, 1996 letter, as supplemented, we understand the relevant facts to be as follows. "U" began its operations as a market-maker in OEX options on the CBOE in October 1995.^{3/} "U's" general partner, "A", is a registered CPO who currently operates one commodity pool, "X".^{4/} "A" is a CBOE member, and he trades on the CBOE as a nominee of "X", which is itself a CBOE member. "A" makes all securities trading decisions for "U", and he will make all trading decisions involving commodity interests for "U".

In your February 9, 1996 letter, you stated that "Y" was one of two limited partners of "U", having contributed approximately two percent of "U's" capital.^{5/} "Y" is a commodity pool, and its general partner is "Z", a registered CPO owned by "B", "C", "D" and "E". The general partner of "Y" is "Z", a registered CPO owned by "B", "C", "D" and "E". Ten of the nineteen limited partners of "Y" are accredited investors (as defined in Rule 501(a)^{6/} promulgated under the Securities Act of 1933)^{7/} including "C" and "E". The remaining nine limited partners are family members of, or entities controlled by, the accredited investors. Approximately thirty-five percent of the assets of "Y" are invested in "X".^{8/}

The bulk of "U's" capital was contributed by its other limited partner, "W". The general partner of "W" is "V", an Illinois corporation, owned by "E" and "D".^{9/} Thirteen of "W's" twenty-three limited partners are accredited investors, including "C" and

^{3/} "U" leases its CBOE seat from "F" and it trades on the CBOE through a nominee, "G".

^{4/} "A" has filed a claim of exemption under Rule 4.12(b) with respect to "X".

^{5/} As of February 29, 1996, you state that "W" has no investment in "U".

^{6/} 17 C.F.R. §230.501(a) (1995).

^{7/} 15 U.S.C. §§ 77a *et seq.* (1994).

^{8/} You represent that in addition to its investment in "X", "Y" "has other investments that trade futures."

^{9/} "E" and "D" are also listed principals of a registered independent introducing broker.

his wife, "E",^{10/} "H",^{11/} "A" and two CBOE traders.^{12/} Ninety to one hundred percent of the assets of "W" are invested in "U", with the remainder, if any, maintained in bank accounts.

In support of your request you represent that none of "U", "Z", "Y", "W", "V" or any of their respective principals is subject to statutory disqualification under Section 8a(2) or 8a(3) of the Commodity Exchange Act (the "Act").^{13/}

"U" hedges its OEX option positions by trading baskets of the stocks comprising the OEX or by using CBOE-traded options to construct synthetic equity positions. "U" endeavors to conclude each trading day in a neutral position, but this is not always possible, due to market conditions. Consequently, "U" seeks to use the SPX futures contract to hedge temporarily any day-end imbalance in its trading portfolio. You represent that "U's" SPX futures trading would probably occur only after market hours (*i.e.*, on the Chicago Mercantile Exchange's Globex[®] system).^{14/}

Except in circumstances involving extreme illiquidity in either the futures or securities markets (such that near simultaneous trading of the position would be impossible, as would be true if futures trading were locked limit-up or limit-down), any futures position would be liquidated and replaced by a corresponding securities (*i.e.*, equity or equity option) position during the next CBOE trading day. "U" is willing to restrict to five percent of its net assets the funds it may use as initial margin for its futures and commodity option positions. You represent that at the

^{10/} "E" is also a principal of "V".

^{11/} "B" is also a principal of "Z".

^{12/} The other accredited investors are a trader on the Chicago Mercantile exchange, a veterinarian, the retired mother of an options trader, a limousine company, an investment banker and a private investor. The non-accredited investors are four entities owned or managed by "C", the owner/president of a finance company, a parimutuel handicapper, a CBOE trader, a sportswriter a financial analyst and a trust for the benefit of the parents of one of the accredited investors.

^{13/} 7 U.S.C. § 12a(2) or § 12a(3) (1994).

^{14/} "A" proposes to use SPX futures positions solely as a protective measure, but he wishes to be able to makes trades during market hours, should the necessity arise.

present time, "U" does not trade in the futures market, either directly or through investments in other funds.

We note that, absent relief, at such time as "U" commences trading SPX futures, it becomes a commodity pool. As a limited partner of "U", "W" will also become a pool, and "V" will become a CPO (obligated to register as such pursuant to Section 4m(1)^{15/} of the Act, and to comply with Part 4 of the Commission's regulations, in connection with the operation of "W").^{16/} You represent that "W" is not involved, directly or indirectly, in commodity interest trading except for "U's" proposed use of SPX futures.

Based upon the representations made in your correspondence, the Division will not recommend that the Commission take any enforcement action against: (1) "A" as CPO of "U" for failure to comply with the disclosure, reporting and recordkeeping requirements of Commission Rules 4.21 through 4.26 solely in connection with the operation of "U"; or (2) "V" as general partner of "W" for failure to register as a CPO and to comply with the disclosure, reporting and recordkeeping requirements of Commission Rules 4.21 through 4.26 solely in connection with the operation of "W". This position, however, is subject to the conditions that: (1) no more than five percent of the net assets of "U" will be used for initial futures margin and commodity option premiums; (2) the only commodity interests traded by or on behalf of "U" will be SPX futures contracts; (3) commodity interest trading by or on behalf of "U" will be conducted on the "emergency" basis as described in your correspondence, to hedge any day-end imbalance in its trading portfolio in order that "U" can conclude its trading for a given day in a neutral position; and (4) apart from its investment in "U", "W" will not, directly or indirectly, engage in commodity interest trading.

This letter is applicable to "A" and to "V" solely in connection with the operation, respectively, of "U" and "W". Furthermore, this letter does not excuse either "A" or "V" from compliance with any other applicable requirements contained in the Act or in the Commission's regulations issued thereunder. For example, "A" and "V" remain subject to the antifraud provisions of Sections 4b

^{15/} 7 U.S.C. § 6m(1) (1994).

^{16/} As noted above, "Y", "U's" other limited partner at the time of your February 9, 1996 letter, is a commodity pool operated as such by "Z", a registered CPO.

and 4^o of the Act^{17/} and to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's regulations.

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", "Y", "W", "Z", "V", including their respective principals or limited partners, change in any way from those represented to us.

Further, this letter represents the position of the Division of Trading and Markets only. It does not necessarily reflect the views of the Commission or of any other division or office of the Commission. 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

^{17/} 7 U.S.C. §§ 6b and 6^o (1994).