



U.S. COMMODITY FUTURES TRADING COMMISSION

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

COMMERCIAL  
FUTURES TRADING COMMISSION  
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96-43

DIVISION OF  
TRADING & MARKETS

May 15, 1996

COMMERCIAL  
FUTURES TRADING COMMISSION  
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Re: Request for Confirmation of Continued Relief from  
Commodity Trading Advisor ("CTA") Registration Re-  
quirements for Registered Commodity Pool Operator  
("CPO") that Advises Rule 4.5 and Rule 4.7 Clients  
and Four Pools Operated by the CPO

Dear :

This is in response to your letter dated January 16, 1996 to the Division of Trading and Markets (the "Division") of the Commodity Futures Trading Commission (the "Commission"), as supplemented by your letters dated March 18, 1996, April 3, 1996 and April 16, 1996 and by telephone conversations with Division staff. By your correspondence you request on behalf of "X", a registered CPO that intends to form and operate four commodity pools (the "Pools"), confirmation of the following:

(1) exemption of "X" pursuant to Commission Rule 4.14(a)(8)<sup>1/</sup> from the requirement to register as a CTA with respect to providing commodity interest trading advice to "V", a registered investment company<sup>2/</sup> for which the notice of eligibility required by Rule 4.5 has been filed;<sup>3/</sup>

<sup>1/</sup> 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).

<sup>2/</sup> "V" is an open-end investment company registered with the Securities and Exchange Commission pursuant to the Investment Company Act of 1940 (the "Company Act"), 15 U.S.C. §§ 80a-1, et seq. (1994).

<sup>3/</sup> Commission records indicate that this notice was filed on July 2, 1985 under "V's" previous name ("Y").

(2) continued availability to "X" of relief from CPO and CTA registration granted by the Division by letter dated May 8, 1987 with respect to the operation of, and provision of advisory services to, "Z", a pension plan group trust (the "Group Trust");<sup>4/</sup>

(3) relief for "X" from the requirement to register as a CTA with respect to providing commodity interest trading advice to six entities and one individual retirement account ("IRA"), each of which is a "qualified eligible client" ("QEC") as defined in Rule 4.7(b) (collectively, the "X" QECs");

(4) relief for "X" from the requirement to register as a CTA with respect to providing commodity interest trading advice to the Pools; and

(5) the absence of a requirement that "X" personnel register as associated persons ("APs") of "X" (in its capacity as a CPO) solely because such personnel communicate with the "X" QECs, or with prospective or actual participants in "V" or the Group Trust.

Based upon the representations made in your correspondence, we understand the relevant facts to be as follows. "X" a Massachusetts general partnership registered with the Securities and Exchange Commission ("SEC") as an investment adviser under the Investment Advisers Act of 1940, as amended (the "Advisers Act").<sup>5/</sup> "X" has heretofore provided commodity interest trading advice to the "V" and to the Group Trust pursuant to a claim of exemption from CTA registration under a Rule 4.14(a)(8),<sup>6/</sup> and to the seven "X" QECs pursuant to claim of exemption provided by Section 4m(1) of the Commodity Exchange Act (the "Act").<sup>7/</sup>

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<sup>4/</sup> The May 8, 1987 letter provided relief from CPO registration similar to that afforded by Rule 4.5 with respect to certain individual pension plans that are subject to the Employee Retirement Income Security Act of 1974 ("ERISA");

<sup>5/</sup> 15 U.S.C. § 80b-1 et seq. (1994).

<sup>6/</sup> Commission records indicate that notice of this claim of exemption was filed on March 13, 1991.

<sup>7/</sup> 7 U.S.C. § 6m(1) (1994). The Act is codified at 7 U.S.C. § 1 et seq. (1994).

The "V" is a registered investment company consisting of twenty-two separate mutual fund portfolios. The Group Trust is an ERISA group trust formed for the purpose of collective investment of the assets of certain pension and profit-sharing plans. With respect to both the "V" and the Group Trust, "X" provides commodity interest trading advice consistent with the limitations set forth in Rule 4.5(c)(2)(i).

With respect to providing commodity interest trading advice to the "X" QECs, "X" claims the exemption provided by Section 4m(1) of the Act. The "X" QECs are: (1) an endowment that is an instrumentality of the Commonwealth of Virginia; (2) an endowment that is a Georgia corporation; (3) a charitable organization that is a New York corporation; (4) a foundation that is an Illinois corporation; (5) a private foundation organized under the laws of the State of New York; (6) a Luxembourg corporation; and (7) the IRA of a wealthy individual.<sup>8/</sup> The "X" QECs were originally solicited as securities advisory clients during the period 1981 through 1992. The size of the IRA account is approximately \$2 million, and the other "X" QECs have assets under management by "X" of from \$15 million to \$232 million. Incidental to the providing of securities trading advice, "X" trades Standard & Poor's 500 Index futures contracts for the "X" QECs' accounts to hedge existing and anticipated equity positions in their respective portfolios. You

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<sup>8/</sup> In determining whether a CTA meets the "no-more-than-fifteen person test" of the Section 4m(1) registration exemption, where the client is other than a natural person, the Division typically "looks through" the client and counts the individual participants therein. Thus, for example, where the client is a limited partnership, the Division generally counts each partner thereof for the purpose of calculating the number of persons advised in the course of the preceding twelve months. See CFTC Interpretative Letter No. 95-39 [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,380 (December 5, 1994). Similarly, where the client is a corporation, the shareholders would be counted. You have not shown that "X" currently meets the no-more-than-fifteen person test under this analysis and you state that you are unable to provide the actual number of shareholders or members of the "X" QECs that are corporations. (The "X" QECs are four corporations, an instrumentality of the Commonwealth of Virginia, a private foundation and an IRA.)

Accordingly, you have not established that "X" qualifies for the exemption from CTA registration afforded by Section 4m(1) with respect to the "X" QECs. In light of the position we are taking below, however, we do not believe this to be prejudicial to your request.

represent that all such trading constitutes "bona fide hedging transactions and positions" within the meaning of Rule 1.3(z)(1).

"X" now intends to organize, operate and provide commodity interest trading advice to the Pools, and "X" has registered as a CPO in connection therewith.<sup>9/</sup> Commodity interest trading for the Pools will be consistent with parameters set forth in the private placement memoranda distributed to the Pools' investors, and will neither be restricted to bona fide hedging transactions, nor subject to the restrictions set forth in Rule 4.5(c)(2)(i).

You state that "X" will offer interests in the Pools to those of the pension plans participating in the Group Trust, the shareholders of the mutual fund portfolios that make up the "V", and the "X" QECs, that meet the criteria of a "qualified eligible participant" ("QEP") as defined in Rule 4.7(a).<sup>10/</sup> Such interests will be offered in a manner consistent with the safe harbor exemption from securities registration afforded by Regulation D<sup>11/</sup> under the Securities Act of 1933, as amended.<sup>12/</sup>

Neither the Group Trust nor the mutual fund portfolios will themselves participate in the Pool offerings.

Based upon the representations you have made to us, including the registration and regulation of "X" both as a CPO and as an investment adviser, the limited group of persons to whom Pool participations will be offered, and the restrictions on "X's" provision of commodity interest trading advice to the "V", the Group Trust and the "X" QECs, we believe your request has merit.<sup>13/</sup> Moreover, if "X" were required to register as a CTA in

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<sup>9/</sup> "X's" registration as a CPO became effective January 31, 1996.

<sup>10/</sup> By letter dated January 24, 1996 the Division granted "X's" request to treat "A" and "B" (both Managing Directors of "X") and "C" (a "X" portfolio manager) as QEPs for purposes of claiming relief under Rule 4.7 with respect to one of the Pools, "W".

<sup>11/</sup> 17 C.F.R. §§ 230.501 - 230.508 (1995).

<sup>12/</sup> 15 U.S.C. §§ 77a et seq. (1994).

<sup>13/</sup> Your request raises various issues with respect to the interplay of CTA registration exemption provisions under Rule 4.14(a)(4), Rule 4.14(a)(8) and Section 4m(1) of the Act. (Rule 4.14(a)(4) grants exemption from CTA registration where a registered CPO provides commodity interest trading advice solely to and for the sole use of the CPO's own pools.) In light of the

(continued...)

connection with providing commodity interest trading to the "X" QECs, "X" could claim exemption under Rule 4.7 from most of the additional regulatory requirements that would arise as a result of such registration. Accordingly, the Division will not recommend that the Commission take any enforcement action under: (1) Rule 4.14(a)(8) against "X" in connection with advising the "V" for failure to comply with the requirements (a) to provide commodity interest trading advice solely to, and for the sole use of, Rule 4.5 entities, and (b) not otherwise hold oneself out as a CTA; (2) Section 4m(1) of the Act for failure to comply with the condition in the Division's May 8, 1987 letter that "X" not otherwise hold itself out as a CTA; (3) Section 4m(1) of the Act against "X" for failure to register as a CTA with respect to the providing of commodity interest trading advice to the "X" QECs; (4) Rule 4.14(a)(4) against "X" for failure to comply with the requirement to provide commodity interest trading advice solely to, and for the sole use of, pools for which "X" is registered as a CPO; or (5) Section 4k(3) of the Act<sup>14/</sup> against any "X" employee for failure to register as an AP of "X", solely with respect to such person's solicitation, or supervision of solicitation, of potential or actual investors in the "V" or the Group Trust in connection with investing in the "V" or the Group Trust.

These positions are, however, subject to the conditions that: (1) "X" will maintain its registration as a CPO under the Act and as an investment adviser under the Advisers Act; (2) with respect to the "X" QECs, "X" will comply with the recordkeeping requirements set forth in Rule 4.7(b)(2)(ii); and (3) each person who solicits or supervises the solicitation of prospective or actual participants in the Pools will be registered as an AP of "X" in "X's" capacity as a CPO.

This letter is applicable to "X" solely in connection with advising the "V", the Group Trust, the "X" QECs and the Pools. Furthermore, this letter does not excuse "X" from compliance with any other applicable requirements contained in the Act or in the Commission's regulations issued thereunder with respect to "X's" CTA activities. For example, "X", in its capacity as a CTA, remains subject to the antifraud provisions of Sections 4b and 4o

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<sup>13/</sup> (...continued)

representations you have made to us, in responding to your request it has not been necessary separately to address these issues.

<sup>14/</sup> 7 U.S.C. § 6k(3) (1994).

of the Act,<sup>15/</sup> to the reporting requirement for traders set forth in Parts 15, 18 and 19 of the Commission's regulations, and to the operational and advertising requirements of Rules 4.30 and 4.41, respectively.

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 "X", or any of "X's" commodity interest advisory clients, 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 office or division 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

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<sup>15/</sup> 7 U.S.C. §§ 6b and 6c (1994).