CFTC Letter No. 99-23

May 19, 1999

Division of Trading & Markets

Re: Denial of No-Action/Interpretative Request and Grant of Exemptive Relief Regarding "O"

Dear :

This is in response to your letter dated March 12, 1999 to the Division of Trading and Markets (the "Division") of the Commodity Futures Trading Commission (the "Commission"), whereby you request that the Division confirm that "O" did not become a commodity pool operator ("CPO") solely as a result of becoming a general partner of "N" and "P"). In the alternative, you request that the Division confirm that "O" is eligible for exemption pursuant to Rule 4.13(a)[1] from the requirement to register as a CPO.

Based upon the representations made in your March 12, 1999 letter, in your prior letters to the Division dated October 28, 1998 and November 20, 1998, and in telephone conversations with Division staff, we understand the facts to be as follows. "N" is a Cayman Islands limited partnership. Prior to September, 1998, the sole general partner of "N" was "Q", a Cayman Islands limited partnership that is registered with the Commission as a CPO. The general partner of "Q", is "R", a Cayman Islands limited liability company that is wholly-owned by "S", which is also registered as a CPO. "N" trades with funds contributed to it by its limited partners, ten feeder funds. Investors participate in "N's" trading profits and losses by becoming participants in one or another of the feeder funds. Each of the feeder funds is operated by "S" and contributes substantially all of its assets to "N". "N" is advised by "S", by "T", and by "U". Each of "T" and "U" is under common ownership with "S" and is registered as a commodity trading advisor ("CTA"). As noted above, "S" is registered as a CPO.[2]

In September 1998, in response to severe financial stress at "N", fourteen financial institutions formed a consortium (the "Consortium") for the purpose of making an investment (the "Investment") in "N" that was "considered necessary at that time in light of the potential risk to the financial community and follow-on harm to the general public in the event that existing market and credit conditions were to suffer further deterioration."[3] The Consortium organized "O" as the entity that would make the Investment. Initially, it had been contemplated that one of the feeder funds, "V", would be the vehicle through which the Investment would be made - *i.e.*, "O" would contribute 99 percent of the Investment to "V", through which the funds would pass to "N", and it would contribute the remaining one percent of the Investment directly to "N" in exchange for a general partner interest in "N". To address certain foreign bank regulatory and tax considerations, it was determined to make "V" and "O" general partners of a new entity, "X", that would in turn contribute all of its assets to "N". "O" contributed 99 percent of the Investment to

"X" and contributed the remaining one percent to "N" in exchange for its general partner interest in "N". In connection with making the Investment, "O" assumed the role of monitoring the operation and management of "N", both directly by acquiring a general partner interest in each of "N" and "X", and indirectly by becoming listed as a principal of "S", the entity through which all trading activities for "N" are coordinated.

Since becoming a general partner of "N", "O" has acted through two groups of individuals. The "Governing Board" consists of one representative from each of the fourteen Consortium members. Six individuals chosen by the members of the Governing Board make up the "Oversight Committee." There are no common members of the Governing Board and the Oversight Committee. Day-to-day investment decisions continue to be made by "Q" and "S" under the supervision of the Oversight Committee, which participates in risk management meetings, subject to the general governance of the Governing Board. The Governing Board is not involved in specific trading decisions and is not informed of "N's" market positions. Such information is restricted to the Oversight Committee members, consistent with their supervisory duties. Ten of the fourteen Governing Board members are registered as associated persons ("APs") or are listed as principals of Commission registrants. Three of the six members of the Oversight Committee are registered as APs or listed as principals of Commission registrants.

The Request

By your correspondence, you ask the Division to concur in your position that "O" should not be required to register as a CPO as a result of becoming a general partner of "N". To support your position, you claim that: (1) under the current scheme of operation, "N" is not a commodity pool within the meaning of the Commodity Exchange Act (the "Act")[4] and the Commission's regulations issued thereunder; and (2) the Commission already has comprehensive jurisdiction over (a) "O", as a listed principal of "S"; (b) "T" and "U", as registered CTAs; (c) "S", as a registered CPO; and (d) most of the members of the Governing Board and Oversight Committee are registered as APs and/or listed as principals of existing Commission registrants.

Analysis

"N" Remains a Commodity Pool

"N" was organized and is operated as a collective investment vehicle for the purpose of trading, among other things, commodity interests. As such it falls within the definition of "pool" in Rule 4.10(d)(1). The Act and the Commission's regulations do not provide for an exclusion from the pool definitions based upon a *de minimis* level of commodity interest trading beneath which a collective investment vehicle is deemed not to be a pool. Similarly, they do not require a minimum number of participants to make an investment vehicle a pool. You claim that since "virtually all of the resources available to "N" following the Investment were contributions made by the Consortium members" and since "O" "has retained ultimate decision making power over "N's" activities," "N" has ceased to be a pool. However, nothing in the Act or Commission rules renders a pool a non-pool because the CPO that operates it is a participant.

You further claim that the Act's definition of CPO speaks of soliciting funds, securities or property "from others" and that the owners of "O" are not "others." If your argument were to prevail, then CPO registration could be avoided where investors formed and funded an entity to operate an investment vehicle that would trade only the funded entity's money. This result is not contemplated by the Act and Commission rules.

In addition, you claim that Portfolio is effectively a joint venture or joint account. This argument and your earlier claims fail to address the continued participation of other investors in the feeder funds, which continue to be limited partners of, and participants in, "N". Whether or not those investors are entitled to a return on the capital contributed by "O", "N" remains structured as a collective investment vehicle that uses pooled funds to trade commodity interests.

Accordingly, we believe that, notwithstanding the Investment, "N" remains a commodity pool.

"O" Is Not Eligible for Exemption under Rule 4.13(a)

You claim that, consistent with the requirements of Rule 4.13(a)(1), "P" receives no compensation for operating "N"; "O" does not operate more than one pool; "O" neither is required to register with the Commission nor is a business affiliate of a person so required; and "O" does not advertise in connection with "N". Thus, you claim that "O" qualifies for exemption from CPO registration pursuant to Rule 4.13(a)(1).

We believe, however, that "O" operates two pools -- "X" and "N" -- inasmuch as it is a general partner of each pool. With respect to "X", in particular, we note that "X" was organized to accept the Investment contributed by the members of the Consortium and to transmit the Investment to "N". A claim of exemption under Rule 4.7(a) has been filed with respect to "X" Absent relief, as the co-general partner of "X", "O" is required to register as a CPO. Accordingly, we cannot agree with your argument that "X" should be ignored in counting the number of pools operated by "O".

Also, while neither the Act nor Commission rules defines "business affiliate" for purposes of Rule 4.13(a)(1), we note that "O" is a principal of "S", a registered CPO, and a co-general partner with "Q", also a registered CPO. We further note that the Commission proposed and adopted Rule 4.13(a)(1) with the primary intention of exempting from CPO registration "those pool operators whose operation of commodity pools is limited to . . . pools that are essentially clubs or family groups (and that meet other specified conditions)."[5] Clearly, this is not the case here.

Accordingly, "O" is outside both the letter and the intent of Rule 4.13(a)(1).

Conclusion Regarding Registration Issues

For the reasons set forth above, we believe that "O" is required to register as a CPO in connection with its activities as a general partner of "N" and "X". With respect to the members of the Governing Board and the Oversight Committee, we believe that each of them must be listed as a principal of "O". However, inasmuch as neither "O" nor anyone acting on its behalf has

solicited or supervised the solicitation of any participants in "N" and will not do so in the future, we do not believe that they need to register as APs of "O".[6] Thus, no member who currently is not in the registration system will be required to take and pass the "Series 3" examination, nor will he or she be subject to the mandatory ethics training for registrants in Rule 3.34. Accordingly, the listing as principals of "O" of those members who currently are not in the registration system should not be difficult or burdensome.

Location of Books and Records

In your correspondence, you note that the only offices of "O" are located in the Cayman Islands. Nevertheless, the activities of the Oversight Committee take place at the offices of "S" in Connecticut. Ordinarily, upon registering as a CPO, "O" would be required to keep and maintain all books and records required by Rule 4.23 at its main business office. However, based upon the fact that all of the supervisory activities conducted by "O" occur in Connecticut, we believe that it would not be contrary to the public interest and the purposes of Rule 4.23 to permit "O" to maintain the required books and records at the offices of "S". Moreover, by letter dated May 13, 1999, "S" has represented that the records kept by "O" will be open to inspection by any authorized Commission personnel. Accordingly, pursuant to the authority delegated by Rule 140.93(a)(1), the Division hereby exempts "O" from the re quirements of Rule 4.23 to the extent that "O" may maintain the books and records required by the rule at the offices of "S" in Connecticut.

The relief granted in this letter relieves "O" solely from compliance with certain requirements of Rule 4.23 as set forth above and does not excuse it from compliance with any other applicable requirements contained in the Act or in the Commission's regulations issued thereunder. Thus, for example, "O" remains subject to all antifraud provisions of the Act, to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's regulations and to all other applicable provisions of Part 4. Moreover, this letter applies solely with respect to "O's" operation of "N" and "X", as discussed above.

This letter, and the exemption granted herein, are based upon the representations provided to us. Any different, changed or omitted material facts or circumstances might render the exemption void. You must notify us immediately in the event that the operations of "O" change in any material way from those represented to us. Further, this relief is prospective only. If you have any questions concerning this correspondence, please contact Christopher W. Cummings, an attorney on my staff, at (202) 418-5445.

Very truly
yours,

I. Michael
Greenberger

Director

[1] Commission rules referred to in this letter are found at 17 C.F.R. Ch. I (1998).

[2] "S" relies upon the exemption from the requirement to register as a CTA provided by Rule 4.14(a)(4), based upon "S's" sole ownership of the general partner of "N's" general partner, and upon "S's" functional role in operating "N".

[3] Pages 1-2 of your March 12, 1999 letter.

[4] 7 U.S.C. § 1 *et seq*. (1994).

[5] 45 Fed. Reg. 51600, 51601 (August 4, 1980).

[6] We concur with your position that listing of the Governing Board and Oversight Committee members on "O's" Form 7-R as principals is sufficient to effect the required listing. Each of the individuals in question has submitted or will submit a Form 8-R in connection with being registered as an AP and/or listed as a principal of his or her primary employer or of a Commission-registered affiliate of that employer.