

COMMODITY FUTURES TRADING COMMISSION
2033 K STREET, N.W., WASHINGTON, D.C. 20581



DIVISION OF
TRADING AND MARKETS

October 16, 1985

Re: Regulatory Requirements Applicable to the
Operation of a Foreign Commodity Pool.

Dear _____:

This is in response to your letter dated July 12, 1985, as supplemented by the Confidential Information Memorandum dated June 26, 1985, in which you requested in connection with the operation by the Investment Consultant of the Company, a British Virgin Islands corporation, and its wholly-owned Subsidiary, a Netherlands Antilles corporation, relief from certain of the requirements applicable to commodity pool operators ("CPOs") under Sections 4k(2), 4m and 4n of the Commodity Exchange Act (the "Act"), 7 U.S.C. §§6k(2), 6m and 6n, and the regulations promulgated by the Commission thereunder. 1/

From the representations made in your letter, as supplemented, we understand the facts to be as follows:

The Company is being organized for the principal purpose of engaging in securities arbitrage trading activities in the United States and other major international securities markets. These activities will involve, among other things, trading in securities, and options on securities, of one or more participants in an extraordinary corporate transaction, such as a merger or acquisition, leveraged buyout, liquidation, reorganization, recapitalization or bankruptcy. . . . Substantially all trading activities conducted by the Company will be carried out through the Subsidiary.

1/ See, e.g., Part 3, 17 C.F.R. Part 3 (1985), which prescribes registration requirements for CPOs (and their principals and associated persons) and Part 4, 17 C.F.R. Part 4 (1985), which prescribes operational, disclosure, reporting and recordkeeping requirements for CPOs.

. . . [I]n addition to the securities arbitrage trading activities referred to above, the Company may also engage to a lesser extent in other investment and trading activities. In that connection, . . . the Company may engage in trading commodity futures and options contracts for speculative purposes. However, . . . the Company has adopted an investment restriction, . . . prohibiting the commitment of more than 10% of the Company's total assets to initial margin deposits or premiums for commodity futures or options contracts. 2/

With the exception noted below, shares of the Company are being offered outside the United States exclusively to investors who are not "United States Persons" (as defined . . .). Shares may not generally be owned by or transferred to any United States Person, and violation of the applicable restrictions on share ownership and transfer may result in compulsory redemption of shares and financial penalties. As indicated [in] . . . the Information Memorandum, 10% of the Company's Common Shares will be owned by "X", a New York partnership which is one of the owners of the Investment Consultant. The Company does not intend to permit any United States Person other than "X" to acquire any shares of the Company.

The Company's investments will be managed by the Investment Consultant. The Investment Consultant is registered as a broker-dealer under the Securities Exchange Act of 1934 and as an investment adviser under the Investment Advisers Act of 1940 and is a member of the leading securities exchanges in the United States. In connection with the proposed activities of the Company, the Investment Consultant intends to register with the Commission as a CPO. . . .

Neither the Company nor the Subsidiary will maintain an office in the United States. The Company's office in the British Virgin Islands will be maintained by the Administrator of the Company, a British Virgin Islands corporation, and the Subsidiary's office in the Netherlands Antilles will be maintained by the Managing Director of the Subsidiary, a Netherlands Antilles corporation. The Administrator of the Company and the

2/ This restriction is set forth on page 12 of the Information Memorandum.

Managing Director of the Subsidiary will be responsible for the following matters relating to the Company and the Subsidiary: (a) maintaining corporate and financial books and records; (b) preparing quarterly and annual financial statements; (c) computing the monthly net asset value of shares; (d) providing subscription agent, registrar, transfer agent and dividend disbursing agent services in connection with the issuance, transfer and redemption of shares and the payment of dividends thereon; and (e) performing all other accounting, administrative and clerical services necessary in connection with the affairs of the Company and the Subsidiary. The Administrator of the Company and the Managing Director of the Subsidiary (which are under the common ownership and control of an international financial institution based in the Netherlands) are engaged exclusively in the business of providing local corporate administrative and management services, comparable to those being provided to the Company and its Subsidiary, on behalf of corporations domiciled in the British Virgin Islands and the Netherlands Antilles. . . . [T]he Administrator of the Company and the Managing Director of the Subsidiary will receive a fixed annual fee based on the net assets of the Company. The Administrator of the Company and the Managing Director of the Subsidiary will not otherwise have any financial interest or participation in the Company or the Subsidiary nor receive any separate remuneration in connection with sales of the Company's shares. Neither the Administrator of the Company nor the Managing Director of the Subsidiary maintains an office or transacts any business within the United States.

. . . [T]he Company has undertaken to furnish to its shareholders an annual report including audited financial statements within 120 days following the close of each fiscal year and quarterly reports including unaudited financial statements within 75 days following the close of each interim quarterly period. 3/

. . . [I]n addition to the items specifically referred to above, the Information Memorandum discloses

3/ These requirements are set forth on page 30 of the Information Memorandum.

information concerning, among other things, the business background of the Investment Consultant; fees and expenses payable by the Company and the Subsidiary; potential conflicts of interest; borrowing policies and brokerage arrangements; the attributes of the Company's shares, and the dividend, redemption, voting and other rights, privileges and restrictions applicable thereto; and tax considerations. 4/

In further support of the relief requested, by letter dated September 23, 1985, the Investment Consultant made the following additional representations:

The ability of the Company to trade in commodity interests to a limited extent is intended to add to the Company's investment performance potential but is not intended to be a primary investment objective, and in our judgment, the financial success of the Company is not dependent upon its ability to trade in commodity interests.

All of the beneficial owners of "X", a New York general partnership which holds a 50% interest in the Investment Consultant and holds 10% of the outstanding Common Shares of the Company, are professional employees of the Investment Consultant. (Such individuals participate in "X" through separate corporations which each of them controls.)

Based upon the foregoing representations, and as you have requested, pursuant to the authority delegated by Rule 140.93(a)(1), 17 C.F.R. §140.93(a)(1) (1985), the Division has determined to exempt the Investment Consultant from certain of the requirements applicable to registered CPOs under Rules 4.21, 4.22 and 4.23. 5/ Rule 4.21 essentially requires each registered CPO to provide prospective pool participants with a Disclosure Document containing specified information and to file three copies of the Document with the Commission. Rule 4.22 essentially requires each registered

4/ Our review of the Information Memorandum confirms these disclosures.

5/ Of course, and as you have acknowledged, this exemption will only become applicable upon the effectiveness of the registration of the Investment Consultant as a CPO. In this regard we note, and as was explained by Division staff in a telephone conversation with you on July 31, 1985, prior to effectiveness of registration the Investment Consultant may not engage in any commodity interest trading -- i.e., neither for hedging nor speculative purposes -- on behalf of the Company.

CPO to furnish pool participants with periodic Account Statements and a certified Annual Report containing specified information and to file three copies of the Report with the Commission. Rules 4.23(a)(10) and 4.23(a)(11) respectively require each registered CPO to make and keep periodic Statements of Financial Condition and of Income (Loss). Specifically, the Division has determined (1) to accept the Information Memorandum of the Company, as it has been submitted to the Division in connection with our consideration of this request and as it may be amended from time to time, 6/ as compliance with Rule 4.21; (2) to accept the unaudited quarterly reports and the audited annual reports of the Company as compliance with Rule 4.22; 7/ and (3) to exempt the Investment Consultant from the requirements of Rules 4.23(a)(10) and (a)(11).

You further have requested that we exempt the Investment Consultant from the requirement in Rule 4.23(a) to maintain at its main business office the books and records specified in paragraphs (2), (4), (5), (6), (8) and (9) of that rule, which basically pertain to such financial records of the Company as are intended to be made and kept by the Administrator -- e.g., a journal of original entry. 8/ In support of this request, and in lieu of specific compliance with this requirement, you have represented that:

(i) any such books and records which are not maintained at the main business office of the Investment Consultant will be maintained at the main business office of the Company or of the Subsidiary, and (ii) upon the request of the Commission representative, the Investment Consultant will provide such books and records as requested at its main business office within 72 hours after the Investment Consultant receives the request.

6/ This exemption presumes that any amendments to the Information Memorandum will not materially alter the nature and scope of the disclosures currently and planned to be made therein.

7/ For this purpose, the requirements of Rule 4.22(a) shall be satisfied by the quarterly reports and the requirements of Rule 4.22(c) shall be satisfied by the annual reports.

8/ The other paragraphs of Rule 4.23(a), for which you have not requested an exemption, basically pertain to records required of the Company's trading activity, for which it is intended that the Investment Consultant will be responsible.

You have not also requested, however, and therefore by this letter we are not also considering, any such exemption from Rule 4.23(b), which

(Footnote continued)

In light of the previous representations you have made to us concerning the Company's overall operations, we believe that these representations concerning certain of the Company's books and records meets the spirit and intent of Rule 4.23. 9/ Accordingly, pursuant to the authority delegated by Rule 140.93(a)(1), your request for exemption from Rule 4.23(a) is hereby granted. 10/

Finally, you have sought relief from the application of Sections 4k(2), 4m and 4n of the Act and the regulations promulgated by the Commission thereunder on behalf of the Administrator and the Managing Director and in connection with their performance of services on behalf of the Company and the Subsidiary. Sections 4k(2), 4m and 4n concern the registration, reporting and related requirements of CPOs (and their principals and associated persons).

In support of this request, you have noted the following to us:

- (i) the prohibition against ownership of the Company's shares by "United States Persons" (other than "X"),
- (ii) the fact that the Company, the Subsidiary, the Administrator of the Company and the Managing Director of the Subsidiary do not and will not maintain any office in the United States, and
- (iii) the limited nature of the Company's proposed commodity trading activities, and [the intended] registration of the Investment Consultant as a CPO and its compliance with all requirements applicable to it in its capacity as the CPO of the Company pursuant to the Act and the regulations thereunder (except as exempted by order of the Commission), . . .

(Footnote continued)

requires each registered CPO to make and keep certain books and records on its personal trading (and on that of its principals).

9/ In this regard, we note that Rule 4.23 generally requires that where the main business office of the CPO is outside the United States, upon the request of a Commission representative the CPO must produce books and records at the place designated within 72 hours after receipt of the request. The purpose of this provision is to ensure that the Commission has "meaningful access" to the information contained in those documents. See 45 Fed. Reg. 51600, 51603 (August 4, 1980).

10/ Here, too, and as you also have acknowledged, this exemption will only become applicable upon the effectiveness of the registration of the Investment Consultant as a CPO.

We further note that Commission staff previously has provided relief similar to that which you have requested based on facts similar to those at issue here. Specifically, the staff has stated that it would not recommend enforcement action based upon the failure of a person operating a commodity pool outside of the United States to register as a CPO where the following facts are present: (1) such person is located outside the territorial United States; (2) such person confines its pool activities to areas outside the territorial United States; (3) none of the participants in the pool is a resident or citizen of the United States; 11/ and (4) no funds or other capital are contributed to the pool from United States sources. See CFTC Staff Interpretative Letter No. 76-21 [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,222 (August 15, 1976). 12/

Accordingly, based upon the foregoing and pursuant to the authority delegated by Rule 140.93(a)(1), the Division will not recommend that the Commission take any enforcement action against the Administrator and the Managing Director in connection with their performance of services on behalf of the Company and the Subsidiary for failure to comply with Sections 4k(2), 4m and 4n of the Act and the regulations promulgated thereunder.

We note that this letter does not excuse the Investment Consultant, the Administrator or the Managing Director from compliance with any other applicable requirements contained in the Act or in the Commission's regulations thereunder. For example, they would remain subject to the anti-fraud provisions of Section 4o of the Act, 7 U.S.C. §6o (1982), and to the reporting requirements for traders set forth in Parts 15, 18 and 19 (1985). Also, the Investment Consultant would remain subject to the reparations provisions of Section 14 of the Act, 7 U.S.C. §18 (1982). Finally, this exemption is applicable solely with respect to the operation of the Company and the Subsidiary. 13/

11/ For these purposes, we do not believe that "X", one of the owners of the Investment Consultant, should be deemed to be a participant. See Rule 4.13(a)(2)(iii) which, for purposes of determining the availability of an exemption from registration for the CPO of a "family, club or small" pool, excludes from the computation of "no more than 15" participants allowable under that exemption such persons as certain immediate family members of the CPO.

12/ See also, Division of Trading and Markets Interpretative Letter No. 84-2 [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,983 (January 17, 1984).

13/ It appears that the Investment Consultant may be exempt from registration as a commodity trading advisor pursuant to Rule 4.14(a)(4). That regulation exempts from registration as a commodity trading advisor any

This letter is based on the information that has been provided to us. Any different, changed or omitted facts or conditions might require us to reach a different conclusion. In this connection, we request that you notify us immediately in the event the operations of the Company or the Subsidiary, including the restrictions on commodity interest trading, change in any way from that as represented to us.

Very truly yours,

Andrea M. Corcoran
Director

cc: Daniel A. Driscoll, National Futures Association

(Footnote continued)

person who is registered under the Act as a CPO and whose commodity trading advice is directed solely to, and for the sole use of, the pool or pools for which it is so registered.