



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and
Intermediary Oversight

James L. Carley
Director

CFTC letter No. 05-15
August 15, 2005
Exemption
Division of Clearing and Intermediary Oversight

Re: Section 4m(1) – Request for Relief from the CPO Registration Requirement

Dear :

This is in response to your letter dated August 27, 2003, to the Division of Clearing and Intermediary Oversight (the “Division”) of the Commodity Futures Trading Commission (the “Commission”), as supplemented by your email messages dated October 30, 2003, November 12, 2003, November 19, 2003, November 20, 2003, March 31, 2004, and June 21, 2004, and telephone conversations with Division staff (the “correspondence”). By that correspondence, you requested relief from the commodity pool operator (“CPO”) registration requirement of Section 4m(1) of the Commodity Exchange Act (the “Act”).¹

Based upon the representations contained in the correspondence, we understand the facts to be as follows. You are both the director of the “Fund” and the President of the Fund’s investment adviser. Investors participate in the Fund through a feeder fund, “A”, of which you are also General Partner. You are not subject to any statutory disqualification under Section 8a(2) or (3) of the Act.²

You intend the Fund to trade interest rate futures contracts, Eurodollar futures contracts, and options on interest rate futures contracts for the limited purpose of hedging the Fund’s portfolio of mortgage-backed securities.³ Currently, there are thirty-four participants in the

¹ 7 U.S.C. § 6m(1) (2000). The provisions of the Act and the Commission’s rules cited herein may be accessed at http://www.access.gpo.gov/uscode/title7/chapter1_.html and www.gpoaccess.gov/ecfr/, respectively.

² 7 U.S.C. § 12a(2) or (3).

³ You have confirmed that all commodity interest positions will be used to establish “*bona fide* hedging transactions and positions,” as that term is defined in Rule 1.3(z)(1).

Fund. But for the fact that seven of these participants are non-accredited investors, you would be eligible to claim the CPO registration exemption of Rule 4.13(a)(3).⁴ The seven non-accredited investors are either your family members or certain of your close friends. With the exception of two of your family members, each of the non-accredited investors has participated in the Fund for over three years.⁵

In support of registration relief, you stated that the Fund could achieve most of its hedging objectives by committing no more than four percent of its liquidation value to establish its commodity interest positions. However, given the relatively low hedge margin on Eurodollar and interest rate futures contracts, the Division believes that the Fund would likely be able to satisfy its hedging objectives using significantly less than four percent of the liquidation value of its portfolio.⁶

Based upon the representations made in the correspondence, including your representations as to the non-accredited investors and your representations that the Fund will trade commodity interests solely for *bona fide* hedging purposes, the Division will not

⁴ Because we are treating your letter as a request for relief from the registration requirement of Section 4m(1) of the Act, it has not been necessary to consider your letter as a request for relief from the pool participant criterion of Rule 4.13(a)(3).

The Division notes that when the Commission adopted the CPO registration exemption of Rule 4.13(a)(3), it specifically noted that there may be persons that do not meet the criteria of Rule 4.13, but that nonetheless, under their particular facts or circumstances, merit relief. Accordingly, the Commission directed staff to continue to issue relief from the CPO registration requirement of Section 4m(1) of the Act on a case-by-case basis. *See* 68 Fed. Reg. 47221, 47228 (August 8, 2003).

⁵ However, these two persons have participated for over two years.

⁶ For example, based upon hedge margins in effect on the Chicago Board of Trade as of June 2, 2005, assuming that the Fund were to hedge half of the value of its portfolio, it appears that the Fund would need to commit just under a half percent of the Fund's assets to establish commodity interest positions using both 10-year U.S. Treasury Note futures contracts and 5-year U.S. Treasury Note futures contracts. Moreover, based upon the various hedging scenarios you presented in the correspondence, it appears that the Fund should be able adequately to achieve most of its hedging objectives using a maximum of one percent of the liquidation value of the Fund's portfolio. In this regard, the Division notes that the commodity interest trading limitation articulated in Rule 4.13(a)(3), allowing for up to five percent of the liquidation value of a pool's portfolio to be used to establish commodity interest positions, in the majority of cases allows for the use of commodity interest positions far in excess of what would otherwise be required to hedge the *entire* value of a pool's portfolio.

recommend that the Commission take any enforcement action under Section 4m(1) of the Act against you for failure to register as a CPO in connection with your activities as director of the Fund. This position is, however, subject to the condition that the aggregate initial margin and premiums the Fund commits to establish its commodity interest positions will not exceed one percent of the liquidation value of the Fund's portfolio.

The relief issued by this letter does not excuse you from compliance with any otherwise applicable requirements contained in the Act or the Commission's regulations issued thereunder. For example, you remain subject to all antifraud provisions of the Act and the regulations, the reporting requirements for traders set forth in Parts 15, 18, and 19 of the regulations, and to all other applicable provisions of Part 4 of the regulations. Also, this relief is subject to compliance with the condition set forth above.

This letter, and the relief issued herein, is based upon the representations that have been made to us. Any different, changed, or omitted facts or conditions might render this letter void. In this regard, you must notify the Division immediately in the event that the operations of the Fund, including its participant composition, change in any material way from those represented to us. Further, this letter represents the position of this Division only and does not necessarily reflect the views of the Commission or any other division or office of the Commission.

If you have any questions concerning this correspondence, please contact R. Stephen Painter Jr., an attorney on my staff, at (202) 418-5416.

Very truly yours,

James L. Carley
Director