



U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5430
Facsimile: (202) 418-5547
aradhakrishnan@cftc.gov

Division of Clearing and
Intermediary Oversight

CFTC letter No. 06-16
July 7, 2006
Exemption
Division of Clearing and Intermediary Oversight

Ananda Radhakrishnan
Director

Re: “A”
Regulations 4.21, 4.22 and 4.23
“B” – Request for relief from certain Disclosure Document, recordkeeping and reporting requirements

“C”
Regulations 4.31 and 4.36
“D” – Request for relief from the Disclosure Document requirement

Dear :

This is in response to your letter dated April 11, 2006, to the Division of Clearing and Intermediary Oversight (the “Division”) of the Commodity Futures Trading Commission (the “Commission”), as supplemented by your letters dated May 4, 2006 and May 26, 2006, by your e-mail messages and by telephone conversations with Division staff (collectively, the “correspondence”). By the correspondence, you request, on behalf of “B”, a registered commodity pool operator (“CPO”), certain relief from Commission Regulations 4.21, 4.22 and 4.23¹ which concern, respectively, the disclosure, reporting and recordkeeping requirements applicable to registered CPOs, in connection with “B” serving as the registered CPO of “A” (the “Fund”). You further request, on behalf of “D”, a registered commodity trading advisor (“CTA”), relief from Regulations 4.31 and 4.36, which concern, respectively, Disclosure Document delivery and filing requirements applicable to registered CTAs, in connection with “D” serving as the registered CTA of “C” (the “Investing Pool”).

Background

¹ Commission regulations referred to in this letter are found at 17 C.F.R. Ch. I (2006). They can be accessed through the Commission’s website, at: <http://www.cftc.gov/cftc/cftclawreg.htm>.

Based upon the representations made in the correspondence, we understand the relevant facts to be as follows. Interests in the Fund (“Shares”) will be offered and sold to the public pursuant to an effective registration statement filed with the Securities and Exchange Commission (“SEC”) (the “Registration Statement”).² The Shares of the Fund will be both publicly-offered and listed for trading on the “D”, and it is this fact that causes “B” to seek relief.³ “D” seeks relief on the basis that it is an affiliated entity under common control with “B”.

The Fund is being structured, and will be offered and listed, in a manner substantially similar to an exchange-traded fund, or ETF.⁴ “B” is the Fund’s CPO, and “D” is the Fund’s CTA. The Fund will seek to approximate the investment performance of a futures index, “F” (the “Index”), as more fully described in the correspondence. Shares will be issued only in one or more blocks of 50,000 Shares (“Baskets”), and in the first instance, only to an initial purchaser, anticipated to be “G” (the “Initial Purchaser”), who will commit to purchase the entire initial public offering upon effectiveness of the Registration Statement.⁵ The Initial Purchaser

² Prior to making the instant request, “B” filed the relevant offering materials for review with both the National Futures Association (“NFA”) and the SEC.

³ Your request states that the Shares constitute securities for purposes of the U.S. federal securities laws and will be offered, sold and transferred as such. While we may not necessarily agree with your analysis or conclusion on this issue, the Division will not recommend that the Commission commence any enforcement action against the Fund or market participants in connection with the offer, sale and transfer of Shares in the manner contemplated by your request and the Disclosure Document for the Fund.

Further, the Division notes the relief it is providing below will not affect “B”’s obligation to comply with any other provision of the Commodity Exchange Act (the “Act”) or the Commission’s regulations issued thereunder applicable to CPOs in particular or to persons in general. The Act is found at 7 U.S.C. § 1, *et seq.* (2000), and also may be accessed through the Commission’s website, at: <http://www.cftc.gov/cftc/cftclawreg.htm>.

⁴ Unlike a typical ETF, however, the Fund will trade indirectly through a second fund wholly-owned by the Fund and “B”. The purpose of this two-tiered structure is to permit the Fund, which, as a commodity pool, would otherwise have to report its income to direct investors on a Form K-1, to provide information on a Form 1099 or substantially similar form, and thus in a format more akin to that given to ETF investors. This structure is not expected, however, to entail any material additional fees or costs for investors.

For the purpose of this letter the Division is treating both funds as a single commodity pool.

⁵ The Initial Purchaser, a registered broker-dealer, is the entity that sponsors the Index. As such, the Initial Purchaser should have access to all material information concerning the Fund at

will not solicit or actively seek purchasers for Shares, and no person (other than the Initial Purchaser) will have any opportunity to purchase Shares prior to effectiveness of the Registration Statement and the listing of the Shares on the “E”.⁶ Subsequent to effectiveness of the Registration Statement, the Initial Purchaser will accept and fill orders for the Shares.⁷ Additionally, the Fund may issue Baskets to “Authorized Participants” (certain registered broker-dealers who meet certain other requirements and have entered into a contractual arrangement with “B” governing the terms and conditions for creation and redemption of Baskets), rather than directly to members of the public.

Investors will be able to purchase Shares in two different contexts, then. First, upon and subsequent to effectiveness of the Registration Statement, investors may purchase Shares from the Initial Purchaser and, if Authorized Participants decide to create additional Baskets, investors may purchase Shares from those Baskets. Second, investors may purchase Shares on the “E” in the secondary market.

“D” will serve as the Fund’s CTA. “D” and “B” (the Fund’s CPO) are both indirect subsidiaries of “H”, and as such, they share several principals. Currently, “D” provides commodity interest trading advice pursuant to a claim of exemption under Regulation 4.7.⁸ As such, it is not required to prepare and deliver a Disclosure Document to its prospective clients, nor is it required to file a Disclosure Document with NFA.

Discussion

Regulation 4.21

Regulation 4.21(a) requires a registered CPO to deliver a Disclosure Document to prospective pool participants at or before the time the CPO delivers a subscription agreement for

or prior to the time it purchases Shares. Also, it will have had the opportunity to review and comment on successive drafts of the Disclosure Document.

⁶ There will be no “road show” or other selling effort with respect to the Shares prior to the Registration Statement’s effectiveness and the Shares’ listing on the “D”.

⁷ The Initial Purchaser will not receive from the Fund, “B” or any of their respective affiliates any fee or other compensation in connection with sale of the Shares, although the Initial Purchaser may receive commissions and/or fees from investors who purchase the Shares.

⁸ Regulation 4.7 makes available an exemption from CTA Disclosure Document and recordkeeping requirements where a CTA advises only “qualified eligible persons” (“QEPs”) as that term is defined in the regulation.

To date, “D” has advised only QEPs. It filed a notice of claim of exemption under Regulation 4.7 on .

the pool. Regulation 4.21(b) requires a CPO to obtain a signed and dated acknowledgment that a prospective pool participant has received a Disclosure Document before the CPO may accept money or other property in exchange for shares or other units of interest in the pool. The purpose of the regulation is “to protect pool participants – particularly those who are unsophisticated in financial matters – by ensuring that they are informed about the material facts regarding the pool before they commit their funds.”⁹

You request relief from the Disclosure Document delivery requirement of Regulation 4.21 with respect to: (1) the sale of the initial Baskets to the Initial Purchaser and resale of the Shares comprising those Baskets by the Initial Purchaser to the public; and (2) the sale of Shares by the Fund to Authorized Participants as part of the creation of additional Baskets and any resale of those Shares by Authorized Participants to the public. In support of your request for relief, you represent that the “I” Internet website maintained by “B” and its affiliates (www. “I” .com), the “E”’s website and the SEC’s EDGAR database (collectively, the “Website Sources”) will contain a current Disclosure Document for the Fund.¹⁰ You further state that “B” expects that prospective or actual investors will utilize the services of a registered broker-dealer, who will either inform them where they can obtain the current Disclosure Document, or, upon request, will deliver a copy of the current Disclosure Document.¹¹

With respect to secondary market purchases on the “E”, you conclude that “B” is not subject to Regulation 4.21. The Division agrees with this conclusion.¹²

⁹ 44 Fed. Reg. 1918, 1920 (Jan. 8, 1979).

¹⁰ “B” will comply with Regulation 4.26 (which contains various Disclosure Document updating requirements) in connection with updating this Disclosure Document.

¹¹ “B” expects that the instances where the services of a registered broker-dealer would not be utilized would be limited to cases where the party with whom the investor is dealing (such as a bank or trust company, or in the case of a foreign investor, a foreign broker-dealer) is exempt from the requirement to register as a broker-dealer. In such cases, however, the exempt entity would be expected to have acquired Shares from the Initial Purchaser, an Authorized Participant, or another registered broker-dealer.

¹² The CPO’s obligation to deliver a Disclosure Document (and the requirement to obtain a signed acknowledgment of receipt) extends to the direct purchaser of units of participation, and not to persons who purchase from that purchaser. In this regard, the Commission has stated that, with respect to the transfer of a participation unit in a commodity pool, the CPO of the pool “is not required to provide a Disclosure Document (Rule 4.21) to a person who purchases a unit of participation or interest in the pool from a pool participant if the pool operator did not solicit the purchase.” 44 Fed. Reg. 25658, 25659 (May 2, 1979).

Regulations 4.22(a) and (b)

Regulation 4.22(a) requires a registered CPO to deliver to pool participants periodic unaudited Account Statements, which must include, among other information, Statements of Income (Loss) and of Changes in Net Asset Value. Regulation 4.22(b) provides that Account Statements be delivered monthly for pools with net assets of more than \$500,000 and otherwise at least quarterly.¹³ The purpose of these regulations is to “ensure that participants have a reasonably current knowledge of the pool’s trading performance and operating costs.”¹⁴

An issuer of exchange-traded Shares held in book-entry form through the Depository Trust Company (such as the Fund) typically does not readily know the identities of its ultimate beneficial owners. You request relief from the Account Statement delivery requirement on the grounds that that it would be unduly burdensome and costly to require “B” to ascertain on a monthly basis the identities of purchasers of Shares in the secondary market in order to comply with the requirement under Regulations 4.22(a) and (b) to deliver monthly Account Statements to participants in the Fund.¹⁵ In this regard, you explain that, while publicly-offered commodity pools typically provide for redemption of shares no more frequently than monthly, because of the secondary market for the Fund’s shares on the “E”, ownership of the Fund’s shares is expected to change frequently on a daily basis.

In support of your request, you represent that the same information that would otherwise be provided in the Fund’s monthly Account Statements, including the Fund’s net asset value and the certification required by Regulation 4.22(h), will be readily available on the “I” website, of which availability the Disclosure Document will advise participants.¹⁶

¹³ Regulation 4.22(c) requires a registered CPO to distribute a certified Annual Report to pool participants. You have not requested any relief from Regulation 4.22(c) in connection with the operation of the Fund, and the Division understands that “B” will comply with Regulation 4.22(c) in connection with its operation of the Fund. You state in this regard that the burden of ascertaining beneficial ownership once annually is significantly less than having to do so on a monthly basis.

¹⁴ 44 Fed. Reg. at 1922.

¹⁵ You make this request not only with respect to investors purchasing Shares in the secondary market, but also with respect to those purchasing from the Initial Purchaser or from an Authorized Participant. Once an investor has purchased Shares, whether directly from the Initial Purchaser, from an Authorized Participant, or on the “E”, the Shares can be freely sold on the secondary market, and the same difficulties will be encountered in tracking the current owner.

¹⁶ Further, the “E” website will link to the “I” website for other financial information, including the Account Statements. Pursuant to Regulation 4.22(h), a representative duly authorized to bind the CPO must sign an oath or affirmation that, to the best of the knowledge

Regulation 4.23

Regulation 4.23 specifies the types of books and records a registered CPO must make in the course of operating a pool, and requires that those books and records be kept at the CPO's main business address. The books and records must be available to pool participants for inspection and copying during normal business hours, and must be open and available for inspection by any representative of the Commission or the United States Department of Justice. The purpose of the regulation is "to enable pool participants and the Commission to ascertain whether the CPO is dealing properly with pool funds."¹⁷

You request relief from the location requirement of Regulation 4.23(a) such that "B" may comply with the location requirement of that regulation by having books and records of the Fund maintained at the offices of "J", a national banking association affiliated with "B"; "K", the Fund's administrator, a Massachusetts banking corporation; and "L", at their respective addresses as specified in your April 11, 2006 letter.¹⁸

You further ask for confirmation that neither "J", "K", nor "L" will be deemed to be acting as a CPO solely by reason of keeping Fund records in the manner described in your correspondence, which the Division hereby so confirms. In this regard, the Division notes that neither firm will be acting in the manner contemplated by the statutory definition of a "commodity pool operator" – *e.g.*, neither will be promoting the pool by soliciting, accepting or receiving from others property for the purpose of commodity interest trading, and neither will have the authority to hire (and to fire) the Fund's commodity trading advisor, and to select (and to change) the Fund's futures commission merchant.¹⁹

and belief of the individual making the oath or affirmation, the information contained in the Account Statement is accurate and complete.

¹⁷ 44 Fed. Reg. at 1922.

¹⁸ Each of "J", "K" and "L" has provided the Division with signed acknowledgments that Fund books and records may be inspected and copied by any representative of the Commission or the United States Department of Justice and may be inspected and copied during normal business hours by Fund participants. The acknowledgments specify, by subparagraph of Regulation 4.23, the respective classes of books and records that each of "J", "K" and "L" will be keeping.

¹⁹ *See, e.g.*, 49 Fed. Reg. 4778, 4780 (Feb. 2, 1984) (Commission acknowledged staff practice of employing these criteria in determining whether a person is, or is not, a CPO); and CFTC Staff Letter 05-19 [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶30,164 (November 10, 2005) (Division granted a CPO an exemption to keep pool books and records with the pool's administrator and its distributor, neither of which was thereby deemed to be acting as a CPO of the pool).

Regulations 4.31 and 4.36

Regulations 4.31 and 4.36 respectively require each registered CTA to provide a Disclosure Document for the trading program pursuant to which the advisor seeks to direct or guide a prospective client's account to the prospective client by no later than the time the CTA delivers to the prospective client the advisory agreement, and to file the Disclosure Document with NFA. Where the CTA's prospective client is a commodity pool, the CTA provides the Disclosure Document to the CPO of the pool. In turn, the CPO utilizes the information in the CTA's Document in preparing the Disclosure Document that the CPO delivers to prospective participants in its pool. However, although "D" is a registered CTA, because it has claimed exemption under Regulation 4.7 from the requirements of Regulation 4.31, "D" is not currently required to prepare and deliver a Disclosure Document.²⁰

Thus, you have requested relief from Regulations 4.31 and 4.36, such that "D" would not have to deliver a Disclosure Document to "B", its corporate affiliate. In support of your request, you note that: (1) "B" and "D" are both indirect subsidiaries of "M"; and (2) they share certain management personnel. In further support of your request, you represent that "D" will make available to "B" all of the information that "B" needs in order to prepare the Fund's Disclosure Document in accordance with Regulation 4.21.

Conclusion

Based upon the representations made in the correspondence, the Division believes that granting your request would not be contrary to the public interest and to the purposes of the regulations at issue. Accordingly, pursuant to the authority delegated in Regulation 140.93(a)(1), the Division hereby exempts "B" in connection with the operation of the Fund from: (1) the requirement of Regulation 4.21(b) to obtain a signed acknowledgment of receipt of a Disclosure Document before accepting funds, securities or property from a prospective pool participant with respect to sales of Shares to the Initial Purchaser and sales by the Initial Purchaser, or sales of Shares to Authorized Participants and sales by Authorized Participants when Authorized Participants create additional Baskets, subsequent to effectiveness of the Registration Statement, provided that the information required to be contained in the Disclosure Document is maintained and kept current on the Website Sources; (2) the requirement of Regulation 4.22 to deliver monthly Account Statements to purchasers of Shares, provided that the information that would otherwise be contained in such reports is maintained on "B"'s "I" website; and (3) the requirement of Regulation 4.23 to keep required books and records at "B"'s main business office to the extent that such books and records are maintained at the offices of "J", "K" and "L". Consistent with prior practice,²¹ the exemption from the books and records location requirement

²⁰ See n. 8, *supra*.

²¹ See, e.g., CFTC Staff Letter No. 05-19.

of Regulation 4.23 is subject to the conditions that: (1) “B” notify the Division if the location of any of the books and records required to be kept by Regulation 4.23 changes from that as represented to the Division; (2) “B” remain responsible for ensuring that all books and records required by Regulation 4.23 are kept in accordance with Regulation 1.31 and for assuring the availability of such books and records to the Commission, NFA, and any other agency authorized to review such books and records in accordance with the Act and Commission regulations; (3) within forty-eight hours after a request by a representative of the foregoing, “B” obtain the original books and records from the offices of “J”, “K” or “L”, as the case may be, and will provide them for inspection at “B”’s main business office in San Francisco, California; (4) “B” disclose in the Fund’s Disclosure Document the location of its books and records that are required under Commission Regulation 4.23; and (5) “B” remain fully responsible for compliance with Regulation 4.23.

Further, pursuant to the authority delegated in Regulation 140.93(a)(1), the Division hereby exempts “D” from the Disclosure Document requirements of Regulation 4.31 and 4.36 in connection with providing commodity interest trading advice to the Fund.

This letter exempts “B” from Regulations 4.21, 4.22 and 4.23, and “D” from Regulations 4.31 and 4.36, as stated above. It does not excuse “B” or “D” from compliance with any other aspect of the Commission’s disclosure, reporting and recordkeeping requirements applicable to registered CPOs and CTAs, nor does it excuse “B” or “D” from compliance with any other applicable requirements contained in the Act or in the Commission’s regulations issued thereunder. For example, “B” and “D” remain subject to Regulation 1.31, and the Commission maintains its right under that regulation to inspect the required books and records of “B” at the offices of “J”, “K” or “L”, at the addresses provided in the correspondence. Additionally, “B” and “D” remain subject to all antifraud provisions of the Act and the Commission’s regulations, 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.

This letter is based upon the representations made to us and is subject to the conditions set forth above. Any different, changed or omitted material facts or circumstances might render this letter and the exemptions granted herein void. In this connection, you must notify us immediately in the event that the operations of “B”, “D” or the Fund change in any material way from those represented to us.

Page 9

If you have any questions concerning this correspondence, please contact me or Christopher W. Cummings, Special Counsel, at (202) 418-5445.

Very truly yours,

Ananda Radhakrishnan
Director

CWC: cc
cc: Regina Thoele, National Futures Association
Stephen Obie, New York Regional Office