

Commodity Futures Archive - Selected materials, CFTC Interpretative Letter No. 84-5 (Securities Trust Exemption), ¶22,023, Commodity Futures Trading Commission, (Feb. 24, 1984)

¶22,023. Commodity Futures Trading Commission, Division of Trading and Markets. February 24, 1984. Correspondence in full text.

Commodity Pools: Commodity Pool Operators: Registration: Investment Companies.— A securities trust, a newly formed diversified, open-end investment company, would be eligible for exemption under proposed Commission Rule 4.5 of certain otherwise regulated persons for registration as a commodity pool operator and from the provisions of Subpart B of Part 4 of the Commission Regulations, the Trust is a registered investment company and will not be marketed as a commodity pool or otherwise as a vehicle for trading in the commodity interest markets. It will engage in commodity interest transactions solely for bona fide hedging purposes and will disclose, in writing, to its prospective participants the purpose of, and the limitations on the scope of its commodity interest trading. Finally the trust will not deposit as initial margin or premiums for its commodity interest transactions more than 5% of the market value of its total assets.

See ¶4400, "Definitions" division, Volume 1.

This is in response to your letter dated November 2, 1983,¹ as supplemented by your letter dated February 6, 1984 and the prospectus dated February 1, 1984 (the "Prospectus") enclosed therewith, in which you requested an opinion that "T" (the "Trust") would not be a "commodity pool operator" ("CPO") as defined in Section 2(a)(1)(A) of the Commodity Exchange Act, as amended (the "Act"), 7 U.S.C. §2 (1982), nor a "pool" as defined in Rule 4.10(d) of the Commission's regulations, 17 C.F.R. §4.10(d) (1983).

From the representations made in your November 2, 1983 letter, as supplemented, we understand the facts to be as follows: The Trust is a newly formed diversified, open-end investment company registered under the Investment Company Act of 1940. The investment objective of the Trust is "to seek a high current return" by investing in U.S. government securities and trading in certain options on these securities.

The Trust also intends to engage in certain commodity interest transactions based on financial instruments.² These transactions would, however, be subject to certain limitations. The Prospectus, at page 7, sets forth, among others, the following limitations:

The Trust will not engage in transactions in futures contracts or related options for speculation but only as a hedge against changes resulting from market conditions in the values of debt securities held in the Trust's portfolio or which it intends to purchase.... [T]he Trust may not purchase or sell futures contracts or purchase or sell related options if immediately thereafter the sum of the amount of margin deposits on the Trust's existing futures ... positions and for premiums paid for related options would exceed 5% of the market value of the Trust's total assets....

[Further, the Trust's] sale of futures contracts and purchase of put options on futures contracts will be solely for purposes of protecting its portfolio against declines in value. In addition, the Trust expects that in the normal course it will purchase debt securities for its portfolio upon termination of long futures contracts, long call options on futures contracts, and written put options on futures contracts, a substantial majority of the time, but under unusual market conditions, it may terminate any of such positions without a corresponding purchase of debt securities.

On February 2, 1984, the Commission issued proposed Rule 4.5, which would exempt certain otherwise regulated persons from registration as a CPO and from the provisions of Subpart B of Part 4 of the Commission's regulations.

³ See 49 Fed. Reg. 4778 (February 8, 1984). Based upon our review of the representations you have made to us, it appears that the Trust would be eligible for this proposed exemption inasmuch as the Trust: (1) is among the persons and qualifying entities covered by the proposal- *i.e.*, it is a registered investment company; (2) will engage in commodity interest transactions solely for bona fide hedging purposes; (3) will not deposit as initial margin or premiums for its commodity interest transactions more than 5% of the market value of its total assets, (4) will not be, and has not been, marketed as a commodity pool or otherwise as a vehicle for trading in the commodity interest markets; and (5) will disclose in writing to its prospective participants the purpose of and the limitations on the scope of its commodity interest trading.

Accordingly, this Division will not recommend that the Commission take any enforcement action against "T" for failure to register as a CPO or to comply with the provisions of Subpart B of Part 4 of the Commission's regulations.⁴ This

position is, however, subject to the condition that the Trust will comply with Rule 4.5 as adopted by the Commission or with any other such rule that the Commission may adopt to exempt certain otherwise regulated persons from regulation as a CPO.⁵ Therefore, this position will cease upon the effective date of Rule 4.5 or of such other rule.

In this connection, we note that previously we have issued opinions to certain registered investment companies that they would not be pools within the meaning and intent of Rule 4.10(d) based upon representations similar to those made by the Trust.⁶ However, in light of the Commission's recent proposal in this area, we believe that such a "no-action" position is the appropriate relief that should be afforded at this time. We further note that with respect to such investment companies and the filing of certain notices proposed in Rule 4.5, the Commission has stated:

[We do] not believe that it should be necessary for the recipients of such interpretative letters to, in effect, "re-submit" an application for exemption—*i.e.*, to file an initial notice of eligibility—in the event the proposal is adopted. However, to insure that these persons (and entities) would be in compliance with the requirements of the proposed rule, the Commission intends to take the position that such persons must file supplemental notices in the event that any of the representations they previously had made to the Commission changed or that, to the extent that the proposal would require any additional representations, they were not in compliance with them. This position would ensure equal treatment of all persons claiming exemption under the rule. 49 Fed. Reg. 4778 at 4782-83.

We believe, and intend to recommend, that the Commission should take this same position with respect to the Trust.

You should be aware that the position we have taken in this letter does not excuse the Trust from compliance with any otherwise applicable requirements contained in the Act or in the Commission's regulations thereunder. For example, it remains subject to the anti-fraud provisions of Section 4 *o* of the Act, 7 U.S.C. §6 *o* (1982), and to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's regulations, 17 C.F.R. Parts 15, 18 and 19 (1983), as amended.

The position we have taken herein is based upon the representations that have been made to us. Any different, changed or omitted facts or conditions might require us to reach different conclusions. In this connection, we request that you notify us immediately in the event the Trust's operations and activities change in any way from that as represented to us.

Footnotes

- 1 Your letter addressed to the Office of the General Counsel was referred to this Division for reply.
- 2 In discussing these commodity interests, the Prospectus, at page 6, explains that "[c]urrently there are futures contracts based on long-term U.S. Treasury bonds, Treasury notes, GNMA Certificates and three-month U.S. Treasury bills."
- 3 Section 4m(1) of the Act, 7 U.S.C. §6m(1) (1982), requires each person who comes within the CPO definition to register as a CPO with the Commission. The provisions of Subpart B of Part 4 concern the operational, disclosure, reporting and recordkeeping requirements of registered CPOs. *See* 17 C.F.R. §§4.20-4.23 (1983), *as amended* by 48 Fed. Reg. 35248 (August 3, 1983).
- 4 Inasmuch as proposed Rule 4.5 would provide exemption for a registered investment company and any principal or employee thereof, the position we are taking herein also would apply to any principal or employee of the Trust—*e.g.*, its officers.
- 5 For example, the rule as adopted may or may not contain the same standards and indicia of bona fide hedging transactions and positions contained in the rule as proposed. Moreover, to the extent that the rule as adopted is less restrictive than the rule as proposed—with respect to the standards and indicia of bona fide hedging transactions and positions or to any other aspect of the proposal—the Trust would be able to trade commodity interests subject to such other restrictions provided, or course, that such trading is conducted in accordance with the rule as adopted.
- 6 *See Pension Hedge Fund/Inc.*, Comm. Fut. L. Rep. (CCH) ¶21,908 (available November 3, 1983); *SteinRoe Bond Fund, Inc.*, Comm. Fut. L. Rep. (CCH) ¶21,906 (available October 21, 1983); *Prudential-Bache Option Growth Fund, Inc.*, Comm. Fut. L. Rep. (CCH) ¶21,905 (available September 13, 1983). *See also Piedmont Income Fund, Inc.*, Comm. Fut. L. Rep. (CCH) ¶21,910 (available November 21, 1983).