



DIVISION OF  
TRADING AND MARKETS

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

November 20, 1985

Re: CPO No-Action Postion

Dear \_\_\_\_\_:

This is in response to your letter dated October 11, 1985, in which you request on behalf of the Fund that the Division not recommend that the Commission take any enforcement action against the Fund if it fails to register as a commodity pool operator ("CPO") in connection with the trading of commodity interests by the different investment funds it operates.

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

The Fund is a non-profit membership corporation. Its members are exclusively non-profit educational organizations. The powers of the Fund are vested in a Board of Trustees selected by member institutions that, in turn, retains a management staff.

The Fund is organized under legislation enacted by the State of New York. The legislative charter authorizes the creation of a company to provide a means for inter-institutional cooperation among educational organizations in management of financial resources. The purpose of the legislation, and the Fund, is to help educational organizations defray, at least in part, rapidly increasing educational costs by improved endowment management.

To encourage creation of an organization under the legislative charter, the Ford Foundation made a substantial grant in the early 1970s to pay the administrative, operating and management costs of the Fund during its start up phase. This grant paid all of the organizational expenses and also served to defray a portion of the operating expenses of the Fund for the first three years. Thereafter the Fund has operated on a self-sustaining but non-profit basis, with members

paying a pro rata share of expenses in proportion to their investments.

Although the Fund has grown substantially, it is now, as it has always been, a non-profit membership corporation owned, operated and controlled exclusively by participating member colleges. The Fund now has six different investment funds each of which is managed by several independent investment advisory firms or banks, as follows:

The Fund for Short Term Investments with more than 500 members and assets of approximately \$2.0 billion.

The Fund for Equity Investments with approximately 200 members and assets of approximately \$500 million.

The Fund for Equity Income Investments with about 50 members and assets of about \$175 million.

The Fund for Bond Investment with over 100 members and assets of over \$200 million.

The Fund for International Investments with approximately 40 members and assets of about \$200 million.

The Fund for Global Bond Investments that was established on July 1, 1985 and is just getting started.

Prior to the filing of your "no-action" request, the President of the Fund sent us the organization's Rules. In particular, Rule 1.3 provides:

Only Funds which are exclusively the property of a member institution for its educational, charitable or scientific purposes may be deposited. . . .

In this regard, we note that prior to joining the Fund an educational institution receives a copy of the organization's Rules which explain, among other things, the following: expenses, distributions, withdrawals and investment policies. In addition, the Rules require each member to receive audited annual reports with respect to each investment fund and quarterly reports which generally include lists of the assets of the funds.

The Fund now also is interested in having these investment funds trade commodity interests. In this regard, your letter explains that, as in the case of all Fund activities, commodity interest trading strategies will be

designed and implemented only for members wishing to use them. Your letter also provides examples of possible trading strategies, including the following:

[An] asset allocation strategy, in which the Fund [would] use futures contracts to reduce or increase exposure of portfolios of securities to movements in the prices of stocks or bonds. In the asset allocation program, the majority of the assets would be invested in long positions in stocks or bonds. The underlying positions would remain relatively constant with futures contracts being used to vary the market exposure within an overall limit of 100%. . . .

. . . [I]n connection with the establishment of a new South Africa Free Fund[,] . . . Value Line Futures would be sold and S&P futures bought simultaneously to hedge out the extra market risk of holding a portfolio of stocks in companies with relatively smaller capitalization.

. . . [S]elling Treasury bill futures to hedge a long position in money market securities, or selling Treasury bond futures to hedge a bond portfolio against interest rate rises.

In support of your request, you note that such commodity interest trading would be subject to certain restrictions. Specifically, your letter represents:

The Fund proposes only to use futures contracts in ways incidental to the management of the long positions of common stocks, bonds and money market securities in the investment funds now managed by it and in other investment funds it may manage in the future. The Fund will not use futures contracts for leverage but only to adjust risks associated with existing investments in an amount that will never be greater than the value of those investments. The Fund will not commit more than five percent of any fund under its supervision (including any pool in which funds may be invested for asset allocation) to initial margin on futures contracts and premiums on commodity option contracts.

You also assert that as a membership organization controlled by, and solely responsive to requests for assistance in endowment management from, its members, the Fund is not a person intended to be regulated as a CPO under the Commodity Exchange Act, as amended (the "Act"). In support of this assertion, you provide the following information concerning the Federal tax status of the Fund:

On November 3, 1970, the Internal Revenue Service issued a ruling that the Fund was exempt from Federal income tax under Section 501(c) (3) of the Internal Revenue Code (the "Code"). One basis for the ruling was that administrative costs of the Fund were provided by the grant from the Ford Foundation. To assure continued eligibility as a Section 501(c) (3) organization after grant funds were exhausted, members of the Fund sought and obtained legislation enacted on June 8, 1974 (Public Law 93-310), adding to the Code a new Section 501(f).

Section 501(f) provides that an organization organized and operated solely for collective investment of the funds contributed thereto by each of its members and to collect income therefrom and turn over the entire amount, less expenses, to such members will be "treated as an organization organized and operated exclusively for charitable purposes." The provision limits the membership of such a tax exempt organization to non-profit, educational institutions and to tax exempt organizations administering investment funds for publicly supported colleges and universities. The Senate Report on the legislation, S. Rep. 93-888, makes clear that Congress intended that 501(f) was to cover organizations formed and controlled by investing educational institutions themselves but that Section 501(f) is not available to any organization formed to furnish investment services by private interests -- such as a private brokerage company or an investment advisory company -- even though such organizations might make their services available exclusively to educational organizations. 1/

Preliminarily, we note that you also have sought a similar "no-action" position if the Fund fails to register as a commodity trading advisor ("CTA") in connection with the trading of commodity interests by these funds. The term "commodity trading advisor" is defined in Section 2(a) (1) (A) of the Act, 7 U.S.C. §2 (1982), to mean --

[A]ny person who, for compensation or profit, engages in the business of advising others . . . as to the

---

1/ Moreover, by letter dated August 12, 1985, the Fund's president indicated that although more than ten years has passed since the enactment of Section 501(f), he is unaware of any other group of colleges which has formed a non-profit investment organization similar to that of the Fund.

value of or the advisability of trading in [commodity interests].

Consistent with the Fund's prior operating practices, however, it appears that "independent investment advisory firms" will be providing such advice to the funds and that they, but not the Fund, would be acting as a CTA. In this regard, we note that at page 8 of your letter you represent that the Fund --

will, in all cases, obtain confirmation that outside advisors who engage in futures trading for its various funds are registered as commodity trading advisors.

Accordingly, we believe it unnecessary to pass upon this additional "no-action" request.

The term "commodity pool operator" is defined in Section 2(a)(1)(A) of the Act, 7 U.S.C. §2 (1982) to mean --

any person engaged in a business which is of the nature of an investment trust, syndicate or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property . . . for the purpose of trading in any commodity for future delivery on or subject to the rules of any contract market, but does not include such person not within the intent of this definition as the Commission may specify. . . .

Section 4m(1) of the Act, 7 U.S.C. §6m(1) (1982), generally requires each person who comes within the statutory definition to register with the Commission as a CPO. 2/

Pursuant to its authority under the Act, the Commission has adopted rules which provide relief from regulation as a CPO for certain persons. In particular, Rule 4.5 makes an exclusion from the definition of the term "commodity pool operator" available to the persons specified in the rule. 50 Fed. Reg. 15868 (April 23, 1985). The Fund is not, however, among the persons so specified -- e.g., it is not a registered investment company. 3/

---

2/ Part 4 of the Commission's regulations, 17 C.F.R. Part 4 (1985), prescribes operational, disclosure, reporting and recordkeeping requirements for registered CPOs. See Rules 4.20-4.23.

3/ In fact, and as you explain at page 6 of your letter, the Fund --  
has available to it the exemption from [registration as

See Rule 4.5(a). Moreover, it appears that the investment funds the Fund operates would meet some, but not all, of the operating criteria specified in the rule. See Rule 4.5(c)(2). 4/

---

(Footnote continued)

an investment company] provided by Section 3(c)(10) of the Investment Company Act of 1940 for any company organized or operated exclusively for . . . educational . . . purposes, no part of the net earnings of which enures to the benefit of any private shareholder or individual.

4/ For example, based upon your representations concerning restrictions on commodity interest trading (quoted above), it appears that those funds would meet the requirement in Rule 4.5(c)(2)(ii) that they --

[w]ill not enter into commodity futures and commodity options contracts for which the aggregate initial margin and premiums exceed 5 percent of the entity's assets. . . .

Based upon your representations and explanations concerning trading strategies, however, with respect to the first two strategies -- i.e., asset allocation and arbitrage between two different stock index futures contracts -- it does not appear that in every case those funds would meet the requirement in Rule 4.5(c)(2)(i) that they --

[w]ill use commodity futures or commodity options contracts solely for bona fide hedging purposes within the meaning and intent of §1.3(z)(1); [or] in the alternative, with respect to [certain] long positions . . . which . . . would not come within the meaning and intent of §1.3(z)(1), as a substitute for compliance with this paragraph (c)(2)(i) a qualifying entity may represent that the underlying commodity value of such contract at all times will not exceed the sum of: [certain specified items]. [Emphasis added.]

In this regard, we wish to emphasize that we are passing solely upon whether these trading strategies meet the requirements of Rule 4.5(c)(2)(i), not whether they are prudent or appropriate. As the Commission explained when it adopted Rule 4.5:

[T]he Commission's intent in adopting the §4.5 criteria is to distinguish when certain entities should be treated as commodity pools and their

(Footnote continued)

Notwithstanding the fact that the Fund appears to be outside the scope of Rule 4.5, we believe that relief from regulation as a CPO should be provided to it. This belief is based upon, among others, the representations that the Fund: (1) is a non-profit membership corporation, whose members are exclusively non-profit educational organizations within the meaning of Section 501(f) of the Internal Revenue Code; (2) is "controlled by, and solely responsive to requests for assistance in endowment management from," those members; (3) will commit no more than five percent of any fund it operates to initial margin for futures contracts and premiums on commodity option contracts; (4) will use commodity interests for any such fund in a manner incidental to the operation of such fund's cash portfolio; and (5) "will, in all cases, obtain confirmation that outside advisors who engage in futures trading for its various funds are registered as commodity trading advisors." Accordingly, based upon the representations made to us, the Division will not recommend that the Commission take any enforcement action against the Fund if it fails to register as a CPO in connection with the trading of commodity interests by the different investment funds it operates.

We note that this "no-action" position does not excuse the Fund from compliance with any other applicable requirements contained in the Act or in the Commission's regulations thereunder. For example, the Fund remains 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 of the Commission's regulations, 17 C.F.R. Parts 15, 18 and 19 (1985).

This letter is based upon the information that has been provided to us. Any different, changed or omitted facts or conditions might require us to reach a different conclusion. 5/ In this connection, we request that you

---

(Footnote continued)

operators as CPOs -- and not to establish what should be regarded as prudent trading strategies. 50 Fed. Reg. 15868 at 15876.

5/ For example, if the Fund were to market an investment fund it operates as a commodity pool or as a trading vehicle in which commodity interest trading was not incidental to a cash portfolio, the position taken by this letter would no longer obtain. See 50 Fed. Reg. 15868 at 15879. See also, Division of Trading and Markets Interpretative Letters 85-13 and 85-15, 2 Comm. Fut. L. Rep. (CCH) ¶22,734 (August 2, 1985) and ¶22,736 (August 8, 1985), respectively.

Page 8

notify us immediately in the event that the Fund's operations, including the restrictions on commodity interest trading, change in any way from that as represented to us.

Very truly yours,

Andrea M. Corcoran  
Director