

T4 M 86-7

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



DIVISION OF
TRADING AND MARKETS

February 6, 1986

RE: "No-Action" Position for CPO of Foreign Pool.

Dear :

This is in response to your letter dated January 16, 1986, as supplemented by your letter dated January 24, 1986, in which you requested confirmation that the Division will not recommend that the Commission take any enforcement action against any director or the administrator 1/ of the Fund as a result of engaging in the activities described below without registering as a commodity pool operator ("CPO") pursuant to Section 4m(1) of the Commodity Exchange Act (the "Act"), 7 U.S.C. §6m(1) (1982). 2/

1/ For the purposes of this letter, and as your correspondence requests, the term "administrator" includes any United States affiliate of the administrator or any principal of the administrator or its United States affiliates.

2/ You also have requested a "no-action" position on behalf of any director of the Fund and the Fund's administrator in the event that they engaged in the activities described below without registering as a commodity trading advisor ("CTA") pursuant to Section 4m(1). In light of the nature of the responsibilities of those persons as described below -- i.e., essentially only the selection and the review of the Fund's outside investment managers, we do not believe that their activities would, however, require them to register as a CTA. See 49 Fed. Reg. 4778 at 4780 (February 8, 1984), wherein the Commission explained that Rule 4.20(a), 17 C.F.R. §4.20(a) (1985), which establishes certain organizational requirements for CPOs, is intended to clarify the responsibility of CPOs for the activities and investment policies of their pools. The Commission further explained:

[F]requently, Commission staff is called upon by members of the public to offer guidance on determining who, in fact, would be the CPO of a particular pool. In providing such guidance, the staff typically looks

(Footnote continued)

Based upon the representations made in your correspondence, we understand the facts to be as follows:

The Fund

The Fund is an open-ended investment company incorporated in the Cayman Islands and resident in Guernsey (Channel Islands). The Fund is not registered with the Securities and Exchange Commission as an investment company under the Investment Company Act of 1940. None of the participating shares of the Fund (the "shares") are registered with the Securities and Exchange Commission under the Securities Act of 1933. The shares may not be directly or indirectly offered or sold in the United States of America (including its territories, possessions and areas subject to its jurisdiction) or to or for the benefit of a United States person. 3/

(Footnote continued)

at such factors as who will be acting in the manner contemplated by the statutory definition of the term "commodity pool operator" -- e.g., who will be promoting the pool by soliciting, accepting or receiving from others, property for the purpose of commodity interest trading -- and who will have the authority to hire (and to fire) the pool's CTA and to select (and to change) the pool's FCM.

3/ Specifically, your correspondence represents that the placing memorandum in respect of the shares defines the term "United States person" for the purposes of this restriction as follows:

a national or resident of the United States of America, a partnership organized or existing in any state, territory or possession of the United States of America, a corporation organized under the laws of the United States of America or of any state, territory or possession thereof or any estate or trust other than an estate or trust the income of which from sources outside of the United States of America (which is not effectively connected with the conduct of a trade or business within the United States of America) is not included in gross income for the purposes of computing United States federal income tax.

In a telephone conversation held with Division staff on January 31, 1986,

(Footnote continued)

The Fund is comprised of 5 individual funds, including a fixed income fund and an equity fund investing in securities issued and traded in the United States. Trading in each individual fund is directed by investment managers selected by the board of directors of the Fund. Each investment manager exercises sole investment discretion with respect to that portion of the individual fund's assets which is allocated to it, subject to guidelines adopted by the board of directors. (The board of directors may from time to time establish guidelines for the use of commodity futures contracts and commodity options contracts ("futures contracts") by commodity trading advisors and, in certain circumstances, direct that such guidelines be implemented.) The board of directors of the Fund has responsibility for reviewing the investment performance of each investment manager and, to the extent deemed desirable, dismissing investment managers and hiring new or additional investment managers. The board of directors is assisted in this function by the administrator which is responsible for providing the board of directors with such statistical and other information respecting investment management results as the board of directors may require. . . .

Management and Administration of the Fund

The management of the Fund is under the control of the board of directors. The board of directors is comprised of 4 directors, one of whom, "X," is a U.S. citizen and a principal of "Y," a domestic investment consulting firm which is registered with the Securities and Exchange Commission as an investment adviser pursuant to the Investment Advisers Act of 1940. [Neither "X" nor "Y" is directly or indirectly affiliated with any Commission registrant. 4/] All

(Footnote continued)

your associate represented that we may interpret the foregoing as prohibiting the use of a foreign corporation (or other such entity) by United States residents or citizens for the purposes of evading the restriction on sales of the Fund's shares to a "United States person."

4/ This representation also was made by your associate in the January 31, 1986 telephone conversation held with Division staff.

Your correspondence further represents that "X" has been a principal of

(Footnote continued)

meetings of the board of directors have been, and will in the future be, conducted outside of the United States and all other activities of the directors related to the management of the Fund have been, and will in the future be, conducted outside of the United States.

The administrator of the Fund is "Z," a limited liability company incorporated in Guernsey, Channel Islands. The administrator is empowered to delegate its administrative responsibilities and to retain consultants. It will not, however, delegate its administrative responsibilities, directly or indirectly, to any United States person or other person located in the United States. ^{5/} Pursuant to its authority, the administrator has delegated certain of its administrative responsibilities, including certain recordkeeping, valuation and reporting duties, to the custodian of the Fund, bank and trust company of Guernsey, Channel Islands.

(Footnote continued)

the firm since its inception in the 1970s and that, as of June 30, 1985, the aggregate asset value of all multiple manager investment programs supervised by the firm substantially exceeded one billion dollars.

^{5/} In this regard, your correspondence explains that the administrator is indirectly affiliated with certain United States firms, including "Y". Your correspondence further represents, however, that while the administrator may retain its affiliates to perform certain ministerial functions -- e.g., verification of asset valuations and transmission of information on investment managers, no affiliate will receive a fee for performing any such service. Rather, the affiliate only will receive reimbursement for its "direct out-of-pocket" expenses incurred in performing such service.

Further in support of the requested relief your correspondence represents that neither any director (or affiliate) of the Fund, the administrator (or affiliate) of the Fund, nor any principal of any of the foregoing persons has been subject within the last ten years to any material civil, criminal or administrative action which would adversely reflect upon such person's fitness to act in a fiduciary capacity.

Futures Trading Activity

It is anticipated that a portion of the assets of certain of the individual funds comprising the Fund may be committed to investment in futures contracts in the United States. The discretion to invest any assets of the Fund in futures contracts will, however, only be granted to an investment manager if it is registered as a commodity trading advisor with the National Futures Association, exempt from such registration under the Act or otherwise not required to so register under the Act.

Under existing agreements the aggregate underlying commodity value of all futures contracts in a particular manager's investment portfolio would not be permitted to exceed the aggregate value of cash and cash market instruments in that manager's investment portfolio. As a result of this restriction, it is extremely unlikely (given existing margin levels) that more than 5 percent of any individual fund's net assets would ever be committed at any one time to initial margin and premiums -- even if every investment manager exercising discretion over the assets of the individual fund were authorized to invest, and to the fullest extent of its authority did invest, in futures contracts. 6/

As you are aware, Commission staff has considered the application of the registration requirements of Section 4m(1) of the Act to the CPO of a "foreign" commodity pool on several prior occasions. For example, Commission staff previously 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 with the Commission where, among other things, 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; and (4) no funds or other capital are contributed to the pool from United States sources. CFTC Staff Interpretative Letter No. 76-21, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,222 (August 15, 1976). See also Division of Trading and Markets Interpretative Letter No. 85-18, Comm. Fut. L. Rep. (CCH) ¶22,786 (October 16, 1985) (with respect to the foreign administrator and the foreign

6/ We note that for the purposes of this letter it has not been necessary for us to consider and to opine on whether such trading of futures contracts would come within the definition of the term "bona fide hedging transactions and positions" set forth in Rule 1.3(z), 17 C.F.R. §1.3(z) (1985).

manager of a foreign commodity pool). Cf. Division of Trading and Markets Interpretative Letter No. 84-2, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,983 (January 17, 1984) (wherein Commission staff similarly issued a "no-action" position to, among other persons, a United States domiciled firm based upon a finding that the trading vehicle at issue was not a commodity pool within the meaning and intent of Rule 4.10(d), 17 C.F.R. §4.10(d) (1985)). In certain other cases, however, Commission staff declined to issue such a "no-action" position. ^{7/} See Division of Trading and Markets Interpretative Letter No. 85-18, supra (with respect to the United States domiciled Investment Consultant of a foreign commodity pool; Division of Trading and Markets Interpretative Letter No. 83-14, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,967 (June 6, 1983) (where all of the officers and all but one of the directors of a foreign general partner of a foreign commodity pool were United States residents and citizens and where the foreign general partner was a wholly-owned subsidiary of a Commission registrant and maintained an office in the United States)).

The instant case does not fall squarely within either category of cases Commission staff previously has considered. On the one hand, it presents the following facts which similarly were present in the "no-action" cases: (1) the commodity pool activities of the Fund will be confined to areas outside the territorial United States; (2) none of the participants in the Fund may be a United States resident or citizen; and (3) no funds or other capital may be committed to the Fund from United States sources. On the other hand, like those cases where staff declined to issue a "no-action" position but provided certain other relief, it presents the fact that "X," one member of the Fund's Board of Directors, is a United States citizen.

In this regard, we note that the instant case presents such further facts as: (1) all meetings and all other activities of the Board of Directors related to the management of the Fund have been, and will in the future be, conducted outside of the United States; (2) "X" is but one of four directors of the Fund; and (3) neither "X" nor "Y" is directly or indirectly affiliated with any Commission registrant. In light of these further facts, we believe that the instant case more closely resembles those cases in which Commission staff issued a "no-action" position.

Accordingly, based upon the representations you have made to us, the Division will not recommend that the Commission take any enforcement action against any director or the administrator of the Fund as a result of engaging in the activities described above without registering as a CPO.

^{7/} In those cases staff required the CPO of the foreign commodity pool to register as such but provided relief from, among other things, the disclosure and reporting requirements of Rules 4.21 and 4.22, respectively, 17 C.F.R. §§4.21 and 4.22 (1985).

We note that this letter does not excuse any person covered thereby from compliance with any other applicable requirements contained in the Act or in the Commission's regulations thereunder. For example, each would remain subject to the anti-fraud provisions of Section 40 of the Act, 7 U.S.C. §60 (1982), and to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the regulations, 17 C.F.R. Parts 15, 18 and 19 (1985). Moreover, the position we have taken herein is solely applicable to such persons in connection with their operation of the Fund.

This letter is based upon the representations that have been made to us. Any different, changed or omitted facts or conditions might require us to reach a different conclusion. 8/ In this connection, we request that you notify us immediately in the event that operations of the Fund, including its shareholder and Board of Directors compositions, change in any way from that as represented to us.

Very truly yours,

Andrea M. Corcoran
Director

8/ For example, the "no-action" position issued herein may no longer obtain in the event "X" becomes affiliated with a Commission registrant or if another United States resident or citizen becomes a member of the Fund's Board of Directors.