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

DIVISION OF
TRADING AND MARKETS

Interpretative Letter No. 87-5

September 29, 1987

Re: Educational Marketing Clubs

Dear Dr. :

This is in response to your letter dated August 11, 1987, as supplemented by telephone conversations with Division staff, wherein you sought our views on commodity pool operator ("CPO") regulation in connection with the operation of certain producer marketing clubs ("PMCs") and student marketing clubs ("SMCs") (collectively educational marketing clubs ("EMCs")) by the (" "), including its agents and employees, and any other person whose involvement with any such club may bring him within the CPO definition -- e.g., the president of the club. 1/

In your letter you represent the following:

I. Producer Marketing Clubs

1. Purpose of PMC's. Agricultural producers traditionally use just one type of marketing strategy -- they make cash sales of their commodities and price them on the date of delivery. Generally speaking, agricultural producers do not use forward cash contracts, futures or options. In the past,

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1/ Your letter broadly sought relief for the operators of EMCs conducted by other educational organizations and other States. Consistent with Division policy in issuing interpretative letters, however, and as the staff previously advised you, the position we are taking below is limited to those EMCs with which the specifically is familiar. Thus, depending on the circumstances, our position may or may not be applicable to any other EMC.

the and other interested groups have sought to educate producers about marketing by offering seminars, short courses, publications, video tapes and computer assisted instruction. While attendance at these programs has been good, few participants ever applied the knowledge they had acquired. PMC's are one method to bridge the gap between the acquisition and the application of commodity marketing knowledge. 2/

2. Legislative History. The 1985 Food Security Act authorized a pilot program in 40 counties nationwide where groups of agricultural producers would be organized, educated, and encouraged to use advance marketing techniques with certain financial guarantees provided by the government. Furthermore, [Section 206 of] the Futures Trading Act of 1986 directed the GAO to conduct a study of farmers' use of advance marketing techniques and the educational programs available to them. . . . Finally . . . the , in alliance with the Land Grant universities and colleges, have long used test-plots, demonstration projects, and producer workshops as a proven method for instructing farmers about new management practices and production technologies.

   It is apparent that Congress is concerned about agricultural producers' knowledge and use of advance marketing techniques (including futures and options). Furthermore, the is specifically charged with providing educational programs for farmers and others. Consequently, PMCs appear to be a legitimate way to address the concerns of Congress as expressed in the aforementioned legislation.

3. Historical Background. The began to sponsor and/or support the activities of PMC's in 1984. Similar clubs had been sponsored by the extension service and other groups before but this seems to be the first organized state-wide effort. . . .

4. Form of organization of PMC's. PMC's are organized under a variety of forms. Membership is, of course, voluntary and, consequently, the by-laws (if any) adopted by the club reflect the unique concerns of those individuals willing to associate with the club. . . .

2/ In this regard, you explained to staff that as the purpose of PMCs is to promote interest in the commodity futures and options markets in general, the clubs are not restricted to trading in agricultural commodities.

Generally speaking, the PMC's we are familiar with in are informal associations of agricultural producers who meet for several hours every two weeks. Most clubs were organized by a county extension agent in cooperation with one or more community leaders but the members determine by majority vote what actions the club will take -- e.g., which trades will be placed. 3/ A typical PMC meeting involves one or more of the following activities:

(1) Education. . . .

(2) Price Analysis. . . .

(3) Marketing Strategy/Execution/Evaluation. . . .

5. Compensation Structure of the PMC's. . . . To finance commodity interest trades, clubs collected an average of $80-$100 from each voting member. 4/ Most clubs traded only in mini-futures contracts and purchased out-of-the-money put/call options with relatively small premiums.

More money could have been collected from each member but that would have increased the cost and discouraged participation. Increasing membership to more than 15 appears to be a violation of current CFTC regulations. 5/ However, a $1500 pool of capital would, at most, permit only one or two trades to be made simultaneously with mini-contracts or the entire amount could easily be spent on the premium for just one option. Consequently, permitting PMC membership to expand beyond 15 persons would increase "pool" funds, permit a larger number of simulated marketing actions using futures or options, yet would keep individual contributions to the club's "pool" small.

Other than the individual contributions to the PMC's trading account, no additional fees are charged. Occasionally, county

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3/ Depending on the structure of any given PMC, the trade may or may not be placed by one of the club's officers.

4/ As you explained below with respect to SMCs, you also explained to staff that a monetary commitment to the PMC would more likely promote "real" learning than a hypothetical investment.

5/ See Rule 4.13(a)(2), 17 C.F.R. §4.13(a)(2) (1987), which generally provides exemption from CPO registration where a person collects no more than $200,000 for all of its pools and has no more than 15 participants in each of its pools.

agents may provide educational materials at cost or the PMC may subscribe to agricultural market newsletters. Most guest speakers and other educational materials are provided at no cost to the club.

Most PMC's cease meeting at an agreed upon date (usually during the spring). At that time, any funds left in the club's account are distributed equally. Occasionally, clubs approve a second contribution to fund trades but these additional levies are approved only by majority vote.

6. PMC Operation and Advice. Except for the coordinating activities of the county extension agent and/or other community leaders, most clubs are operated by and for its members. Most clubs make up their own minds about what actions, if any, are appropriate given the existing market situation and the clubs simulated marketing strategies. PMC's receive education and advice from many sources: the extension service, farm publications, market newsletters, farm organizations, brokers, neighbors, feedlot and elevator managers, grain merchandisers, etc. Except for the subscription cost of publications and newsletters, no club pays for advice from any of these sources.

7. Membership. Membership in PMC's is as diverse as the population of most small towns. However, because most clubs are organized to address a particular issue (agricultural marketing), three-quarters of the membership seems to be full-time farmers and ranchers.

II. Student Trading Clubs 6/

1. Purpose. Many degree-granting institutions teach courses in agricultural marketing and/or commodity futures. A feature common to many of these courses is the "paper" trading game. . . .

The problem with "paper" trading is that little, if any, "real" learning takes place and the typical student's approach to the exercise is to treat it as if it were a game of chance. Since no "real" money is involved, the student never has to bear responsibility for the trades and few students take the time to investigate market fundamentals, assess alternative

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6/ In your telephone conversations with staff you explained that you intended to develop and to teach this course at . We have phrased the facts, then, in light of this explanation.

trading strategies, or to relate commodity trading to commodity marketing activities (i.e., hedging commodity sales and purchases).

In order to correct the shortcomings of "paper" trading, [you propose to] form Student Trading Clubs (STC's). These clubs would function in much the same manner as Producer Marketing Clubs but their activities may differ. For example, a STC conducted as part of a course on commodity futures at would likely include a large number of agriculture majors. These students would probably concentrate on agricultural commodities but rather than trying to simulate actual farm marketing situations, they may focus solely on price direction and could just as easily buy and sell commodity futures. 7/ In addition, non-agricultural commodities may attract their attention.

There are several advantages to this method of instruction:

(1) With only a limited pool of capital to trade, groups of students would be assigned to specific commodities and encouraged to develop detailed market analysis, to present and defend their trading recommendations, and to conduct ex-post evaluations of actual trades.

(2) Making decision means accepting and living with the consequences of those decisions. . . . Although the dollar value is small, the psychological impact of club trading losses is significant and can be beneficial.

2. Historical and Legislative Background. To [your] knowledge, there are no STC's operating as part of any college or vocational agricultural curriculum. To the extent that an STC serves the educational needs of future farmers and agribusiness managers, then the same congressional mandate that would apply to Producer Marketing Clubs should be extended to Student Trading Clubs.

3. Form and Organization of the STC. Organization of STC's would probably be under the direction of the class instructor. . . but the decision making authority [would] rest with the student members. Formal by-laws and procedures (minutes, treasurer reports, written trade recommendations) [would be] recommended. While the students [would] be encouraged to draw

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7/ As with PMCs, however, to promote maximum participation SMCs would not be restricted to trading in agricultural commodity interests.

on a variety of information sources, it is hoped that they will develop their own analytical skills when assessing commodity markets. Obviously, [I] would take a far more active role in guiding the club's activities than would a county extension agent working with a PMC.

4. Compensation of the STC. Membership [would] be voluntary but only contributing members [would be able to] vote on trade recommendations. Any funds remaining at the end of regular scheduled classes [would] be disbursed equally to all contributing members. Few, if any, additional club expenses are anticipated.

5. Membership of the STC. Membership would be restricted to students duly enrolled in the institution. . . . [W]e intend to offer it as a 1 hour seminar concurrently offered with a 3 hours course in commodity futures. A grade will be assigned but other similar seminars could be set up on a credit/no credit basis.

Rule 4.10(d) defines the term commodity "pool" to mean "any investment trust, syndicate or similar form of enterprise operated for the purpose of trading commodity interests" (emphasis added). In explaining this definition, the Commission stated:

> Whether a particular entity is operated "for the purpose" of trading commodity interests and, thus, is a pool within the scope of §4.10(d), depends on an evaluation of all the facts relevant to the entity's operation. The Commission recognizes that in the past its staff has issued interpretations of the Part 4 rules. Consistent with that practice, the Commission invites interested persons to seek such staff interpretations of §4.10(d) and of all the other Part 4 rules. 46 Fed. Reg. 26004, 26006 (May 8, 1981).

The definition of the term "pool" closely follows the definition of the term "commodity pool operator" contained in Section 2(a)(1)(A) of the Commodity Exchange Act, as amended (the "Act"), 7 U.S.C. §2 (1982). Specifically, Section 2(a)(1)(A) provides in pertinent part:

> The term "commodity pool operator" shall 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 . . . property . . . for the purpose of trading in [commodity futures contracts], but does not include such persons . . . as the Commission may specify. . . .

The term "commodity pool operator" was added to the Act by the Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, §202,

88 Stat. 1389 (1974). The legislative history of this addition indicates that it was intended to bring CPOs within the Commission's jurisdiction for the purpose of protecting unsophisticated investors from undesirable managerial and trading practices. 8/

The Division previously has had occasion to consider whether, in light of the foregoing, a particular trading vehicle would be a commodity pool and, thus, whether its operator would come within the CPO definition. Generally speaking, the Division found that there would be no pool and no CPO thereof where the participants were family members or had known each other for several years and where the idea and formation of the trading vehicle were the products of all persons involved. 9/ Such factors are not present in the instant request.

Certain other factors are, however, present. Specifically, we note the educational purpose of the EMCs and the fact that they will be promoted and effectively sponsored by (and the). Based upon those factors, and in furtherance of the purpose of the CPO definition, the Division will not recommend that the Commission take any enforcement action for failure to register as a CPO against the , including its agents and employees, the president of any EMC and any other person whose involvement with an EMC would require him to register as a CPO provided the following conditions are met: (1) each participant in the EMC receives in writing the statement prescribed by Rule 4.13(b), to the effect that the organizer of the pool is not registered as a CPO and is not subject to Disclosure Document and Annual Report requirements; (2) no participant contributes more than $300 to any EMC; (3) the EMC has no more than 50 participants; (4) the EMC has a specific expiration date; (5) the commodity interest trading account of the EMC is opened and traded in the name of the club; and (6) any withdrawal from the account is requested in writing and is signed by two members of the club, of which facts the futures commission merchant carrying the account must be informed in writing.

You should be aware that the "no-action" position expressed in this letter does not excuse any person who may claim it from compliance with any otherwise applicable requirements contained in the Act or in the Commission's regulations thereunder. For example, each such person remains subject the anti-fraud provisions of Section 4o of the Act, 7 U.S.C. §6o (1982).

8/ See, e.g., Statement of Dr. Clayton Yeutter, Assistant Secretary of Agriculture, House Committee on Agriculture Report on the Commodity Futures Trading Commission Act of 1974, H.R. Rep. No. 93-975, 93d Cong., 2d Sess., 79 (1974).

9/ See, e.g., Division of Trading and Markets Interpretative Letters No. 86-10 and 86-17, Comm. Fut. L. Rep. (CCH) ¶23,016 (April 24, 1986) and ¶23,200 (June 24, 1986), respectively.

The position taken in this letter is based on the representations you have made to us and is subject to compliance with certain conditions, as set forth above. Any different, changed or omitted facts or conditions might require us to reach a different conclusion. In this connection, we request that you notify us immediately in the event the EMC programs are not conducted as set forth above.

Very truly yours,

Andrea M. Corcoran
Director