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93-3
Office of Communication and Education Services
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Advisory

Advisory 6-93

For Release: February 3, 1993

Relief Granted to Certain CPOs Who Wish to Convert Their Pools to 4.12(b) Pools

The Commodity Futures Trading Commission's Division of Trading and Markets has issued Interpretative Letter 93-3, which states that the Division will not recommend that the Commission take any enforcement action against certain registered commodity pool operators who were operating or selling a pool in full compliance with Part 4 of the Commission's rules if they subsequently operate the pool pursuant to Rule 4.12(b). The Division's letter notes that recently adopted Commission Rule 4.7(a)(3)(i)(2) provides a mechanism for CPOs who have offered or sold their pools in full compliance with Part 4 to subsequently claim relief under Rule 4.7, but that Rule 4.12(b) does not specifically address the issue of a CPO who wishes to claim 4.12(b) relief for a pool subsequent to commencement of commodity interest trading by the pool. The Division's letter provides no-action relief that makes Rule 4.12(b) relief available subject to conditions patterned after the requirements for pools converting to Rule 4.7 status.

Specifically, the Division conditioned its relief upon compliance with the following requirements, among others: (1) the operation of the pool pursuant to the relief available in Rule 4.12(b)(2) is otherwise consistent with the duties of the CPOs and the rights of the pool's participants; (2) the CPOs will notify the pool's participants that, absent objection within 21 days after the date of the notification by the holders of a majority of the units of participation in the pool unaffiliated with the CPOs, the CPOs intend to operate the pool pursuant to Rule 4.12(b); (3) such majority holders have not objected within that period; and (4) the CPOs either continue to comply in full with Rules 4.21, 4.22 and 4.23 with respect to objecting participants or allow such participants to redeem their units of participation within three months following the date of notification of the CPOs' intention to operate the pool pursuant to Rule 4.12(b). The relief also was conditioned upon the CPOs' amending the pool's Disclosure Document so as to bring it into compliance with the disclosure requirements applicable under Rule 4.12(b), e.g., to disclose that the pool will not enter into commodity futures and commodity option contracts for which the aggregate initial margin and premiums exceed 10 percent of the fair market value of the pool's assets.

Copies of the letter are available from the Commission's Office of Communication and Education Services, (202) 254-8630.



COMMODITY FUTURES TRADING COMMISSION

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**DIVISION OF
TRADING AND MARKETS**

December 21, 1992

Re: Unrestricted Pool Becomes Rule 4.12(b) Pool

Dear Mr. :

This is in response to the letter dated October 5, 1992 from A, B, and C, the registered commodity pool operators ("CPOs") of D (the "Pool"), requesting under Rule 4.12(a) the relief available pursuant to Rule 4.12(b).^{1/} Our review of the request indicates that, as is explained below, the CPOs have not met all of the requirements of Rule 4.12(b).

Rule 4.12(b)(1)(i)(C) specifies that the pool for which a CPO is claiming Rule 4.12(b) relief may not enter into commodity futures and commodity options contracts for which the aggregate initial margin and premiums exceed 10 percent of the fair market value of the pool's assets. Rule 4.12(b)(1)(ii) states that participants in the pool must be informed in writing of this restriction. However, the Pool's Disclosure Document dated June, 1992 and filed with the Commission on June 17, 1992, states on page 21 that "the Commodities Manager intends to limit the percentage of net assets of the Partnership invested in commodities margin and premiums to no more than 15% of net assets at any time."

Further, Rule 4.12(b)(5)(i) requires that if a claim of exemption has been made with respect to Rule 4.12(b)(2)(i), the CPO must make a statement to that effect on the cover page of each offering memorandum, or amendment thereto, that it is required to file with the Commission pursuant to Rule 4.21(g). However, the Pool's Disclosure Document does not contain such a statement.

Finally, Rule 4.12(b)(4)(i) specifies that the claim of exemption pursuant to this rule must be filed before the date the commodity pool first enters into a commodity interest transaction. The Pool began trading securities and commodity interests in August, 1992, without the CPOs having first filed a claim of exemption pursuant to Rule 4.12(b).

^{1/} Unless otherwise indicated, Commission rules referred to herein are found at 17 C.F.R. Ch. I (1992).

Based upon the foregoing, it appears that the CPOs are seeking to convert a pool which they operate in compliance with Part 4 to a Rule 4.12(b) pool, a situation that is not specifically addressed by Rule 4.12(b). However, recently adopted Rule 4.7^{2/} does provide a mechanism for CPOs who have offered or sold their pools in full compliance with Part 4 to subsequently claim relief under Rule 4.7 (and, thus, to effectively convert their pools into "Rule 4.7 pools"). Specifically, Rule 4.7(a)(3)(i)(I)(2) provides that a CPO may claim an exemption under Rule 4.7 with respect to a pool it has commenced operating provided that: (1) the claim for exemption is otherwise consistent with the duties of the CPO and the rights of the pool participants; (2) the CPO has notified the pool participants that, absent objection within 21 days after the date of the notification by the holders of a majority of the units of participation in the pool unaffiliated with the CPO, he intends to claim Rule 4.7 relief; and (3) such holders have not objected within that period. The CPO would then be required either to continue to provide disclosure and reporting in accordance with the requirements of Part 4 to objecting participants or allow them to redeem their units of participation within three months of the filing of the Rule 4.7 notice.

We believe that a similar mechanism should be available to the CPOs with respect to Rule 4.12(b). Accordingly, the Division will not recommend that the Commission take any enforcement action against the CPOs if they operate the Pool pursuant to the relief available in Rule 4.12(b)(2) in lieu of full compliance with Rules 4.21, 4.22 and 4.23, provided that: (1) the operation of the Pool pursuant to the relief available in Rule 4.12(b)(2) is otherwise consistent with the duties of the CPOs and the rights of the Pool's participants; (2) upon receipt of this letter the CPOs notify the Pool's participants that, absent objection within 21 days after the date of the notification by the holders of a majority of the units of participation in the Pool unaffiliated with the CPOs, the CPOs intend to operate the Pool pursuant to Rule 4.12(b); (3) such majority holders have not objected within that period; and (4) the CPOs either continue to comply in full with Rules 4.21, 4.22 and 4.23 with respect to objecting participants or allow such participants to redeem their units of participation within three months following the date of notification of the CPOs' intention to operate the Pool pursuant to Rule 4.12(b). This no-action position is further subject to the condition that the CPOs amend the Pool's Disclosure Document so that it complies with the informational requirements of Rules 4.12(b)(1)(C) and 4.12(b)(5)(i), referred to above in the second

^{2/} 57 Fed. Reg. 34853 (August 7, 1992). Rule 4.7 provides relief from certain Part 4 requirements to registered CPOs who have only "qualified eligible participants" in their pools.

and third paragraphs of this letter. Specifically, the Disclosure Document must be amended to state that the Pool will not enter into commodity futures and commodity option contracts for which the aggregate initial margin and premiums exceed 10 percent of the fair market value of the Pool's assets and the Pool must be operated in accordance with such statement. The Document also must be amended to state on the Document's cover page that pursuant to relief issued by CFTC staff, the Document has been prepared in accordance with Rule 4.12(b)(2)(i).^{3/} Further, pursuant to Rules 4.21(b) and (g), the amended Document must be distributed to existing and previously solicited prospective pool participants and filed with the Commission as set forth in those rules.

This letter is based upon the representations that have been made and is strictly limited to those representations and to compliance with the conditions set forth above. Any different, changed or omitted facts or circumstances might require us to reach a different conclusion. In this connection, we request that you notify us immediately in the event the operations of the Pool change in any way from those as represented to us. Further, this letter represents the views of the Division of Trading and Markets only. It does not necessarily represent the views of the Commission or of any other office or division of the Commission.

If you have any questions concerning this correspondence, please contact me or Barbara S. Gold, Assistant Chief Counsel, at (202) 254-8955.

Very truly yours,

Susan C. Ervin
Chief Counsel

^{3/} Similarly, the CPOs should comply with the requirements of Rule 4.12(b)(5)(ii) by stating on the cover page of each Annual Report that pursuant to relief issued by CFTC staff, the Annual Report has been prepared in accordance with Rule 4.12(b)(2)(iii).