COMMODITY FUTURES TRADING COMMISSION
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94-22

DIVISION OF
TRADING AND MARKETS

January 24, 1994

Re: Request for CPO Registration No-Action Position

Dear :

This is in response to your letter dated October 28, 1993, to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by telephone conversations and by additional correspondence dated November 18, 1993, and December 13, 1993. By your letter you request, on behalf of your client, "A", that the Division not recommend that the Commission take any enforcement action against "A" for failure to register as a commodity pool operator ("CPO") in connection with his serving as a member of the board of directors of an offshore commodity pool, as explained more fully below.

Based upon the representations contained in your letter, as supplemented, we understand that the facts are as follows. "U", an offshore investment banking corporation, is in the process of forming an offshore commodity pool to be organized as a corporation in and under the laws of (the "Fund"). The Fund is being created for the purpose of providing an investment alternative to clients of (the "Bank"), a bank and an affiliate of "U". "U" and the Bank have arranged for and are paying for the organization of the Fund. The Fund will not be registered with the Securities and Exchange Commission as an investment company under the Investment Company Act of 1940 or under the Securities Act of 1933.[1/]

[1/] We note that in furtherance of the antifraud provisions of Section 4o of the Commodity Exchange Act, the Division has issued an Advisory concerning material information that must be displayed with respect to "guaranteed" commodity pools, such as the Fund appears to be. See Division of Trading and Markets Advisory No. 86-1, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,035 (April 25, 1986). In particular, the Division stated that:

> [A]ny statements that suggest that the risks of futures trading are decreased by reason of [a guarantee] structure have a high potential to mislead or deceive and could result in serious violations of the . . . anti-fraud provisions.

(continued...)

The units of the Fund will not be directly or indirectly offered or sold in the United States (including its territories, possessions and areas subject to its jurisdiction) or to or for the benefit of a United States person.[2/] The management shares of the Fund will be owned by two corporations -- "U" will hold fifty percent of the shares and "V", a corporation to be formed in the British Virgin Islands, will hold the remaining fifty percent of the shares. The management shares of the Fund represent the voting shares of the Fund and will be purchased for nominal consideration. "A" and other U.S. persons or entities (none of whom is a Commission registrant or is affiliated with a Commission registrant) will beneficially own an interest in "V".[3/] You represent that ownership of the management shares does not confer any greater authority upon the holders of the shares than that conferred upon a member of the board of directors. Holders of the management shares will not participate in the day-to-day operations of the Fund. The Fund is structured into units and management shares as a means of providing the voting rights of the corporation to persons other than the investors (i.e., the unit holders). "V" will not purchase any units of the Fund. Neither of the corporations that hold the management shares will participate in the profits and losses of the Fund.

Approximately seventy percent of the Fund's investment assets will be invested in securities. With respect to the remaining assets of the Fund, approximately twenty-one percent of the Fund's investment assets will be invested in securities of funds (the "Sub-funds") that purchase short term United States government debt instruments. The Sub-funds are deemed "mutual funds" under the terms of the Mutual Funds Law of the Cayman Islands. It is contemplated that the remaining nine percent of the Fund's investment assets will be available for trading in commodity interests in the United States.

1/ (...continued)

Id. at pp. 32,058-59. This letter should in no way be construed as approving or passing upon the Fund's disclosure materials or any other aspect of its operations.

2/ The definition of "United States person" set forth in Interpretative Letter No. 92-3, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,221 (January 29, 1992) applies for purposes of this correspondence.

3/ You represent that "A" will hold less than ten percent of the interest in "V".

The management of the Fund will be under the control of the board of directors. The board of directors will be comprised of four directors, each of whom, with the exception of "A", will be a non-United States person. The board of directors will select the portfolio manager for the Fund. All meetings of the board of directors will be conducted outside of the United States and all other activities of the board of directors related to the management of the Fund will be conducted outside of the United States.

It is anticipated that "W", which is registered with the Commission as an introducing broker, commodity trading advisor ("CTA") and CPO, will be engaged as the Fund's portfolio manger and will be responsible for allocating among CTAs the Fund's assets for investment in commodity interests, subject to the approval of the board of directors. The discretion to invest any assets of the Fund in commodity interests will be granted to an investment advisor only if it is duly registered with the Commission in the appropriate capacity or exempt from such registration under the Commodity Exchange Act (the "Act").[4/]

The administrators of the Fund will be its officers, all of whom will be non-United States persons. The administrators will be empowered to delegate their administrative responsibilities and to retain consultants. The administrators will not, however, delegate their administrative responsibilities, directly or indirectly, to any United States person or other person located in the United States. Recordkeeping, valuation and reporting duties are expected to be handled by "X" and "Y", located in the British Virgin Islands.

As noted, "A" will be one of the four members of the board of directors. You have represented that his seat on the board of directors is a formality. He has been asked to sit on the board as an honorary designee as a consequence of his relationship with "Z", New York Branch.[5/] He is not subject to a statutory disqualification under Section 8a(2) or 8a(3) of the Act.[6/] He will not be involved in any solicitation activities on behalf of the Fund, nor will he control or supervise on a day-to-day basis the operations of the Fund.

4/ 7 U.S.C. § 1 et seq. (1988 & Supp. IV 1992).

5/ "A" was an employee of "Z", New York Branch from 1966 until 1986. His position in 1986 when he retired was Senior Vice-president, Corporate Banking Division.

6/ 7 U.S.C. §§ 12a(2) or 12a(3) (1988).

You further represent that "A" will not perform any functions that would require his registration as a CPO under the Act or the Commission's regulations,[7] nor hold himself out as a CPO. As one of four members of the board of directors, he will be entitled to attend regular annual meetings and to vote on extraordinary matters that come before the board, such as filling vacancies on the board, approving material contracts or changes thereto, and acting on a resolution to dissolve and liquidate the Fund at the end of seven years.

As you are aware, Commission staff has considered the application of the registration requirements of Section 4m(1) of the Act[8] 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: (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.[9] Similarly, in Division of Trading and Markets Interpretative Letter 86-7,[10] the Division issued a CPO no-action position in connection with the operation of an offshore pool although one of the directors of the offshore pool was a United States person.

The instant case presents facts which closely parallel the facts presented in Interpretative Letter No. 86-7, namely, that (1) the commodity pool activities of the Fund will be confined to areas outside the territorial United States; (2) none of the investors in the units of the Fund will be a United States person; and (3) no funds or other capital may be committed to the Fund from United States sources for the purchase of units of the Fund.

7/ Commission rules referred to herein are found at 17 C.F.R. Ch. I (1993).

8/ 7 U.S.C. § 6m(1) (1988).

9/ See, e.g., Staff Interpretative Letter No. 76-21, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,222 (August 15, 1976).

10/ [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,013 (February 6, 1986).

In addition, we note your representations that: (1) all meetings and all other activities of the board of directors will be conducted outside of the United States; (2) "A" is but one of four directors of the Fund and his appointment as a director is an honorary designation; (3) "A" is not directly or indirectly affiliated with any Commission registrant; and (4) "A" will not be involved in any solicitation activities on behalf of the Fund, nor will he control or supervise on a day-to-day basis the operations of the Fund or perform any functions on behalf of the Fund for which registration under the Act or Commission regulations is required.

In light of the foregoing, the Division will not recommend that the Commission take any enforcement action against "A" for failure to register as a CPO in connection with his serving as a member of the board of directors of the Fund. We note that this letter does not excuse "A" from compliance with any other applicable requirements contained in the Act or in the Commission's regulations promulgated thereunder. For example, he remains subject to the antifraud provisions of Section 4o of the Act,[11/] and to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the regulations. Moreover, the position we have taken herein is solely applicable to "A" in connection with his activities with respect to 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.[12/] In this connection, we request that you notify us immediately in the event that the operations of the Fund, including its shareholder and board of directors compositions, change in any way from those as represented to us. Further, the position taken herein represents the position of the Division only. It does not necessarily represent the views of the Commission or of any other unit or division of the Commission.

[11/] 7 U.S.C. § 6o (1988).

[12/] For example, the no-action position issued herein may no longer be applicable in the event "A" becomes affiliated with a Commission registrant or if another United States resident or citizen becomes a member of the Fund's board of directors.

If you have any questions concerning this correspondence, please contact Tina Paraskevas Shea, an attorney on my staff, at (202) 254-8955.

Very truly yours,

Susan C. Ervin
Chief Counsel