



COMMODITY FUTURES TRADING COMMISSION

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94-94

DIVISION OF  
TRADING AND MARKETS

September 28, 1994

Re: Rule 4.21(a) -- Relief from Requirement To Disclose Joint Developer of Trading System as a Principal of Pool Operator Where Pool Operator Is Not Acting as a Commodity Trading Advisor

Dear :

This is in response to your letter dated July 7, 1994, to the Division of Trading and Markets (the "Division") of the Commodity Futures Trading Commission (the "Commission"), as supplemented by your letters dated August 16, 1994 and September 21, 1994 and by telephone conversations with Division staff. By your letter you request on behalf of "X" that the Division not recommend that the Commission take any enforcement action if "X" fails to comply with the disclosure requirements of Commission Rule 4.21<sup>1/</sup> applicable to "A" as a principal of the commodity pool operator ("CPO") of a pool for which a Disclosure Document is required to be delivered.

Based on the representations in your letter, as supplemented, we understand the relevant facts to be as follows. "X" is currently registered as a commodity pool operator ("CPO"), and is forming a new commodity pool (the "Prospective Pool") for which it intends to act both as CPO and commodity trading advisor ("CTA"). "A" has been registered as an associated person ("AP") of certain futures commission merchants and introducing brokers ("IBs") since 1983. He now owns and operates an IB business. "A" and "B", chief executive officer of "X", have known each other for many years, and in 1991, "A" brought to "B's" attention an idea for a computerized trading system. "X" and "A" agreed to develop and test a new trading system (the "System") based on "A's" idea. "X" intends to use the System to make trading decisions for the Prospective Pool.

You have represented that "B" makes all of the decisions regarding the characteristics of the System, including without limitation, money management guidelines, leverage level and whether

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<sup>1/</sup> The Commission rules referred to herein are found at 17 C.F.R. Ch. I (1994).

any revisions or modifications are made. In addition to "A's" role in forming the original idea for the System and discussing its development with "B", "A" has been involved in testing the System's performance against historical price information and researching possible modifications. Presently, the System is making trading decisions for a proprietary account of "X", in order to test the System's ability to select profitable trades prior to using it to trade customer accounts.

With respect to the proprietary account, "A" enters trades only if and when directed by the System to do so. His only other responsibilities for "X" are to observe the operation of the System and to suggest possible improvements.<sup>2/</sup> Once trading with customer funds begins, "A" will perform the same functions as he has with the proprietary account and will have no customer contact or control over trading decisions.

You have further represented that "A" is not an officer, director or shareholder, or otherwise involved in the management, of "X" or any related entity. He has no right to obtain an ownership interest in "X" or any related entity. He does not maintain an office at "X" or engage in the solicitation of customers for any of the commodity pools operated by "X". "A's" only business relationship, past or present, with "X" involves the activities referred to above with respect to the System. He has a consulting agreement with "X", and his compensation includes a monthly fee to cover his expenses, and a portion of the incentive fees, if any, earned by "X" using the System.

In support of this request, you undertake on behalf of "X" to list "A" as a principal of "X" (1) in "X's" registration with the National Futures Association, and (2) in the Disclosure Documents for the Prospective Pool and for each other pool for which "X" acts in the capacity of a CTA, (whether or not "X" also acts as CPO). In each instance where "A" is so listed, "X" will make full required disclosure with respect to him, including without limitation, in the case of any Disclosure Document, the actual performance of each account directed by "A" for the three years preceding the date of such Disclosure Document.

Based upon the foregoing representations and compliance with the undertaking and subject to the condition that "X" makes full disclosure concerning the development and performance history of the System, the Division will not recommend that the Commission take any enforcement action against "X" if "X" fails to comply with the requirements of Rule 4.21 regarding disclosure of information concerning "A" as a principal of "X" with respect to pools that are

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<sup>2/</sup> Such improvements can be implemented only with the approval of "B".

operated by "X", but as to which "X" does not act in the capacity of a CTA.

We note that this letter relates solely to compliance with Rule 4.21 with respect to disclosing information concerning "A" as a principal of "X", and does not excuse "X" from compliance with any other applicable requirements contained in the Commodity Exchange Act (the "Act")<sup>3/</sup> or in the Commission's regulations issued thereunder. For example, "X" remains subject to the antifraud provisions of Section 40 of the Act,<sup>4/</sup> to the reporting requirements set forth in Parts 15, 18 and 19 of the Commission's regulations and to all other applicable provisions of Part 4.

The position taken herein is based upon the representations that you have made to us and is subject to compliance with the undertaking set forth above. Any different, changed or omitted facts or circumstances might require us to reach a different conclusion. Therefore, we request that you notify us immediately in the event that the responsibilities or activities of "A", or the operations or activities of "X" change in any way from those as represented to us.

This letter represents the position of the Division only and does not necessarily reflect the position of the Commission or any other office or division of the Commission. If you have any questions concerning this correspondence, please contact me or Christopher W. Cummings, an attorney on my staff, at (202) 254-8955.

Very truly yours,

Susan C. Ervin  
Chief Counsel

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<sup>3/</sup> 7 U.S.C. § 1 et seq. (1988 & Supp. IV 1992).

<sup>4/</sup> 7 U.S.C. § 60 (1988 & Supp. IV 1992).