



U.S. COMMODITY FUTURES TRADING COMMISSION

95-108

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DIVISION OF
TRADING & MARKETS

November 27, 1995

Re: Request for Relief from CPO Registration

Dear :

This is in response to the letter of "X" dated June 13, 1995, as supplemented by letters dated June 23, July 14, August 28, August 31 and October 26, 1995 and telephone conversations with Division staff. By its correspondence, "X" requests that the Division of Trading and Markets ("Division") not recommend that the Commodity Futures Trading Commission ("Commission") commence any enforcement action against (the "Operator"), (the "Fund") or any persons serving on the Fund's board of directors if under the circumstances set forth below none of the directors except the Operator registers as a commodity pool operator ("CPO") in connection with the operation of the Fund.

Based upon the representations made in "X's" correspondence, as supplemented, we understand the relevant facts to be as follows. The Fund will invest and trade in a variety of financial instruments, including commodity futures contracts and options thereon. The Operator will serve as the investment advisor to and as a director of the Fund. The minimum investment required of each investor in the Fund is \$10 million, although the Fund will have the discretion to accept investments of less than this amount.

You anticipate that the Fund's Board of Directors will be comprised of the Operator and six other Directors (the "Other Directors"), each of whom will be elected at the behest of the Operator by a Cayman Islands lawyer who will be retained to represent the Fund and who will serve as the initial subscriber of shares in the Fund. You anticipate that two of the Other Directors will be "A", an Assistant Professor of Economics at University, and "B", a Professor of Mathematics and Computer

Science at College, both of whom are United States persons^{1/} (collectively, the "Professors").

You represent that the Professors will serve as directors of the Fund to aid in compliance with Section 206(3) of the Investment Advisers Act of 1940 (the "Advisers Act"), which requires that the Fund consent to any principal or agency cross-transactions entered into between the Operator and an affiliate due to the inherent conflict of interest involved in such a transaction. The Professors, both of whom have expertise in the use of complex, over-the-counter derivative instruments, will act as directors, independent of the Operator, to ensure that if the Fund enters into such a transaction with an affiliate of the Operator rather than with an unrelated third party, the Fund will nevertheless obtain the best execution price possible for the transaction.^{2/} The Operator currently anticipates that the Fund will enter into and the Professors may be required to give their consent (i.e., determine that the Fund is obtaining the best execution price from its affiliate as opposed to an unrelated third party)^{3/} with respect to various types of derivative transactions, including over-the-counter options on securities and securities indices, swaps and other types of derivative interests. You represent that neither Professor will render any advice or make any decisions as to whether the Fund should trade in commodity interest contracts, which commodity interest contracts it should trade or the timing of any such trades. You further represent that the Professors will not take any part in the marketing or solicitation activity on behalf of the Fund and their presence on the Board of Directors of the Fund is not being used as a marketing device.

^{1/} For the purposes of your letter, you use the definition of the term "United States person" set forth in Commission Interpretative Letter No. 92-3, Comm. Fut. L. Rep. (CCH) ¶ 25,221 (January 29, 1992).

^{2/} For example, if the Operator considers purchasing an over-the-counter derivative product from an affiliate, the Professors would obtain from the Operator a price quote from the affiliate and one or more non-affiliates and would determine which quote provides the best price to the Fund. You note that these price quotes may not be directly comparable and, accordingly, the Professors' expertise will be necessary to compare the quotes received.

^{3/} You state that because any transaction in futures contracts or options thereon will be a brokerage transaction no consent or other action by the Professors will be required for such a transaction even if the Fund uses an affiliate of the Operator as a futures commission merchant for such transaction.

The remaining four Other Directors will be non-United States persons affiliated with "Y", which will serve as the Fund's administrator. None of the Other Directors will be affiliated with the Operator or any other Commission registrant. You represent that none of the anticipated Other Directors is and no future Other Director will be subject to any statutory disqualification under Section 8a(2) or 8a(3) of the Commodity Exchange Act, as amended (the "Act").^{4/} All meetings of the Fund and its Board of Directors are conducted outside the United States.

The Operator will register with the Commission as a CPO and will operate the Fund pursuant to Commission Rule 4.7.^{5/} You represent that the Operator will enter into an agreement with the Other Directors, and the articles of association governing the Fund will include provisions, whereby: (1) the Fund's Board of Directors delegates to the Operator and the Operator agrees to accept responsibility for the operation of the Fund as a commodity pool, the solicitation of investors and the supervision of all activities of the Fund relating to commodity interests;^{6/} and (2) each Other Director and the Operator agree to be jointly and severally liable with each other for any violations of the Act and the Commission's regulations issued thereunder applicable to CPOs committed by any Other Director of the Board or the Operator in connection with its activities with respect to the Fund.

Based on the foregoing, the Division will not recommend that the Commission take any enforcement action against the Operator, the Fund or the Other Directors if the Other Directors fail to register as CPOs in connection with their activities as Directors of the Fund. This relief is, however, conditioned on the following: (1) the Division receives within thirty days from the date of the election of the Fund's Board of Directors a written acknowledgment whereby (a) the Board of Directors delegates to the Operator and the Operator agrees to accept sole responsibility for operating the Fund as a commodity pool, solicitation of investors and supervising all activities of the Fund relating

^{4/} 7 U.S.C. § 12a(2) or § 12a(3) (1994).

^{5/} Commission rules referred to in this letter are found at 17 C.F.R. Ch. I (1994).

^{6/} You represent that the Operator generally will be responsible for making all day-to-day decisions regarding the trading and investment of the Fund's assets. You note, however that the non-commodity interest activities of the Fund, which include investment by the Fund in securities and the handling of general administrative activities, will be supervised by the Fund's Board of Directors as a group.

to commodity interests; and (b) each Other Director and the Operator agree to be jointly and severally liable with each other for any violations of the Act and the Commission's regulations issued thereunder applicable to CPOs committed by any Other Director of the Board or the Operator in connection with its activities with respect to the Fund; (2) the Operator provides to the Division written notice of the names of each of the Fund's Directors within thirty days from the date of their election; and (3) the Operator continues to serve as the CPO of the Fund.

You also request that the Division grant relief to the Operator from certain requirements of Rule 4.23(a) to the extent that such rule requires a registered CPO to keep its books and records at its main business office. In this regard, you represent that the original records of the Fund will be maintained at the offices of the Fund in the Cayman Islands in order to comply with Internal Revenue Service requirements for relief from United States taxation. Duplicate records for the Fund will, however, be maintained at the Operator's principal office in New York City.

The Division has determined that, based upon the representations made to us, it is appropriate to grant an exemption from the requirement of Rule 4.23(a) regarding the location where original books and records must be kept. Based upon your representations and pursuant to the authority delegated by Rule 140.93(a)(1), the Division hereby exempts the Operator from the requirement of Rule 4.23(a) to the extent it requires that the Fund's original books and records be kept at the Operator's main business office, provided that copies of these records are maintained at the Operator's main business office and that, within seventy-two hours after a request of a Commission representative is made, the Operator will obtain the original books and records from the Fund's main office in the Cayman Islands and provide them for inspection at a place located in the United States and specified by the Commission representative.

The relief issued by this letter does not excuse the Operator, the Fund or any directors of the Fund from compliance with any other applicable requirements contained in the Act or the Commission's regulations thereunder. For example, each remains subject to the antifraud provisions of Section 40 of the Act, 7 U.S.C. §60, to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's regulations, and to all other provisions of Part 4. Further, this relief is applicable solely in connection with the operation and activities of the Fund.

The positions taken in this letter are based on the representations you have made to us and are subject to compliance with the conditions stated above. Any different, changed or omitted

Page 5

facts or conditions might require us to reach a different conclusion. In this regard, we request that you notify us immediately in the event the operations of the Fund, including its anticipated shareholder and Board of Directors composition, change in any way from those represented to us.

Finally, the CPO no-action position taken by this letter represents the position of the Division of Trading and Markets only. It does not necessarily reflect the views of the Commission or any other office or division of the Commission. If you have any questions regarding this letter, please contact me or Lawrence Eckert, an attorney on my staff, at (202) 254-8955.

Very truly yours,

Susan C. Ervin
Chief Counsel