

CFTC Letter No. 99-06

October 22, 1998

Division of Trading & Markets

Re: Rule 4.10(d) - Request for interpretation that investee funds operated by the registered CPOs of certain commodity pools solely for the purpose of facilitating the trading of those commodity pools are not themselves commodity pools.

Rules 4.21 and 4.22 - Alternative request for exemption from CPO disclosure and reporting requirements in connection with registered CPOs' operation of certain investee funds solely for the purpose of facilitating the trading of commodity pools operated by those CPOs.

Dear :

This is in response to your letter dated August 3, 1998, to the Division of Trading and Markets (the "Division") of the Commodity Futures Trading Commission (the "Commission"), as supplemented by your letters dated August 19, 1998, September 21, 1998 and September 28, 1998 and by telephone conversations with Division staff. By your correspondence, you request on behalf of your clients "P" and "Q": (1) that the Division issue an interpretation that certain investee funds that trade commodity interests (the "Sub-Funds") are not "pools" as defined in Commission Rule 4.10(d)(1)¹ where the only participants in those investee funds are four commodity pools (the "Feeder Funds") operated by "P" and "Q" for the sole purpose of facilitating the trading of the Sub-Funds and where the Sub-Funds are themselves operated by "P" and "Q"; and (2) in the alternative, exemption from the disclosure and reporting requirements of Rules 4.21 and 4.22, respectively, in connection with the operation of the Sub-Funds. Absent action by the Division, "P" and "Q" would be required, as the CPOs of the Sub-Funds, to prepare and deliver Disclosure Documents and periodic financial reports to themselves, as CPOs of the Feeder Funds.

Based upon the representations made in your correspondence, we understand the relevant facts to be as follows. Each of "P" and "Q" is registered with the Commission as a commodity pool operator ("CPO"). "P" is wholly-owned by "A", who is its chief executive officer and managing member.² "A" is the managing member and 99% owner of "Q". The remaining 1% interest in "Q" is owned by "B", "Q's" general counsel. "A" also is registered as an associated person of each of "P" and "Q".

The Feeder Funds

"P" is the general partner and CPO of three of the Feeder Funds: "R"; "S"; and "T". "Q" is the CPO of the remaining Feeder Fund, "U".³

Investors are permitted to invest in the Feeder Funds (and not in the Sub-Funds). Each Feeder Fund investor receives an offering memorandum that describes the structure and operations of the Feeder Funds and the Sub-Funds, including all expenses, risks, conflicts of interest and trading strategies.⁴ Each Feeder Fund investor receives audited annual financial statements of the Feeder Fund. Investors in "T", "U" and "S" receive the quarterly reports required by Rule 4.7(a) and investors in "R" receive monthly reports as required by Rule 4.22.

The Sub-Funds

The Sub-Funds are limited liability companies that were formed solely in connection with the trading activities of the Feeder Funds. In no case is anyone other than a Feeder Fund or another Sub-Fund a member of a Sub-Fund. You describe "P" and "Q" as "co-advisors" of each of the Sub-Funds. None of the Sub-Funds has a managing member, and you request that the Division deem "P" and "Q" to be the operators of the Sub-Funds.

Three of the Feeder Funds ("R", "T" and "U") invest in and therefore are members of "Y", the Sub-Fund to which you refer in your correspondence as "Holding Company." The fourth Feeder Fund ("S"), together with Holding Company, invests in a second Sub-Fund, "V".⁵ Holding Company is also a member of a third Sub-Fund, "W", which, in turn, is the sole member of the fourth Sub-Fund, "X". "V" and "X" trade commodity interests directly. Holding Company and "W" invest in other Sub-Funds and thus trade commodity interests indirectly.

Analysis

You acknowledge that the Feeder Funds are commodity pools. However, you argue that because the Sub-Funds serve only as conduits for the trading of the Feeder Funds and they accept no other investments, the Sub-Funds should not be considered commodity pools for purposes of the Commission's regulatory program. Rather, you believe that the Sub-Funds are more properly viewed as joint trading accounts or general partnerships in which each of the participants is a joint venturer. You represent that each of the investors in the Feeder Funds receives full disclosure regarding the structure and activities of the Feeder Funds and the Sub-Funds, including their trading performance.

Rule 4.21 generally requires that, prior to soliciting, accepting or receiving funds or other property from a prospective pool participant, a CPO deliver to the prospective pool participant a Disclosure Document that contains specified information. Rule 4.22 requires

that a CPO distribute periodically to pool participants account statements and annual reports containing specified financial information about the pool. Thus, you note that in the absence of relief, the operators of the Sub-Funds ("Q" and "P") would be required to deliver Disclosure Documents and periodic reports to the members of the Sub-Funds. Since in each case the members of the Sub Funds are the Feeder Funds or other Sub-Funds, and the operators of those entities are "Q" and "P", "Q" and "P" thus would be required to deliver these documents to themselves.

Based upon the representations made in your correspondence, we are unable to provide your requested interpretation that the Sub-Funds are not commodity pools. This is because, as Rule 4.10(d)(1) provides, each is "an investment trust, syndicate or similar form of enterprise operated for the purpose of trading commodity interests." However, we do believe it would not be contrary to the public interest or the purposes of Rules 4.21 and 4.22 to relieve "P" and "Q", as operators of the Sub-Funds, from having to deliver Disclosure Documents and financial reports to themselves as the operators of the Feeder Funds. Accordingly, under the authority delegated to it by Rule 140.93(a), the Division hereby exempts "Q" and "P" from the requirements of Rules 4.21 and 4.22 in connection with the operation of the Sub Funds.

This letter does not excuse "P" or "Q" from compliance with any other applicable requirements contained in the Commodity Exchange Act (the "Act"),⁶ or in the Commission's regulations issued thereunder. For example, each remains subject to all antifraud provisions of the Act, to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's rules and to all otherwise applicable provisions of Part 4.

This letter is based upon the representations made to us. Any different, changed or omitted material facts or circumstances might render the exemption provided herein void. In this connection, we request that you notify us immediately in the event that the operations or activities of "P", "Q", each Feeder Fund or any Sub-Fund change in any material way from those represented to us.

If you have any questions concerning this correspondence, please contact Chris Cummings an attorney on my staff at (202) 418-5445.

Very truly yours

I. Michael Greenberger

Director

¹ Commission rules referred to herein are found at 17 C.F.R. Ch. I (1998).

² The members of "P" are "A" and a corporation of which he is the president, sole director and sole shareholder.

³ Two of the Feeder Funds ("U" and "T") are operated pursuant to claims of exemption under Rule 4.7 (a). Another ("S") is operated pursuant to relief substantially similar to that available under Rule 4.7(a). With respect to "R", "P" is required to comply fully with the requirements of Part 4 of the Commission's rules applicable to CPOs.

⁴ In the case of "R" the offering memorandum is required to comply with Rules 4.21 and 4.24 through 4.26.

⁵ As of August 31, 1998 "S's" and Holding Company's respective interests in "V" were 4.95% and 95.05%.

⁶ 7 U.S.C. § 1 et seq. (1994)