RULES and REGULATIONS

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 4 and 140

Commodity Pool Operators; Exclusion for Certain Otherwise Regulated Persons From the Definition of the Term "Commodity Pool Operator"; Other Regulatory Requirements

Tuesday, April 23, 1985

***15868** AGENCY: Commodity Futures Trading Commission.

ACTION: Final rules.

SUMMARY: The Commodity Futures Trading Commission (the "Commission") has adopted § 4.5, which excludes certain otherwise regulated persons from the definition of the term "commodity pool operator" ("CPO") upon the filing of a notice of eligibility. The Commission also has revised § 140.93 to delegate thereunder to the Director of the Division of Trading and Markets the authority to make such special calls as may be necessary to demonstrate compliance with certain provisions of § 4.5. Similarly, and so that it may know the identities of all persons who are operating as a CPO pursuant to an exemption from registration as such, the Commission has revised § 4.13 to require each person who is exempt from registration as a CPO pursuant to that regulation—i.e., the operator of a family, club or small pool—to file the prescribed statement of exemption that it currently is required to deliver to prospective participants under the regulation. Finally, the Commission has adopted a technical revision to § 4.15, concerning the applicability of reparations proceedings to persons exempt from registration as a CPO.

EFFECTIVE DATES: Sections 4.5, 4.15 and 140.93(a)(5) are effective April 23, 1985. Section 4.13(b)(1) will become effective May 23, 1985.

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SUPPLEMENTARY INFORMATION:

I. Introduction

The term "commodity pool operator" is defined in section 2(a)(1)(A) of the Commodity Exchange Act, as amended (the "Act") [FN1] to mean:

FN1 7 U.S.C. 2 (1982).

[A]ny person engaged in a business which is of the nature of an investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise,

for the purpose of trading in any commodity for future delivery on or subject to the rules of any contract market, but does not include such persons not within the intent of this definition as the Commission may specify by rule or regulation or by order.

Section 4m(1) of the Act [FN2] makes it unlawful for any person to engage in business as a CPO without being registered as such. Part 4 of the Commission's regulations [FN3] governs the operations and activities of CPOs, through certain operational, disclosure, reporting and recordkeeping requirements set forth in Subpart B thereof.[FN4] In particular, § 4.10(d) defines the term "pool" to mean "any investment trust, syndicate or similar form of enterprise operated for the purpose of trading commodity interests."[FN5]

FN2 7 U.S.C. 6m(1)(1982).

FN3 17 CFR Part 4 (1984).

FN4 1 See §§ 4.20-4.23. Part 4 similarly governs the operations and activities of commodity trading advisors ("CTAs"). See §§ 4.30-4.32.

FN5 The term "commodity interest" is defined in § 4.10(a) to mean:

(1) Any contract for the purchase or sale of a commodity for future delivery; and

(2) Any contract, agreement or transaction subject to Commission regulation under section 4c or 19 of the Act.

In connection with the adoption of the Futures Trading Act of 1982 (the "1982 Act"),[FN6] the Senate Committee on Agriculture, Nutrition, and Forestry (the "Committee") considered an amendment to the Act which would have exempted the persons specified therein from the CPO definition.[FN7] In this regard, the Commission made the Committee aware of the "not a pool" interpretative letters under § 4.10(d) that had been issued by its Division of Trading and Markets, which is responsible for, among other things, administering and interpreting the Part 4 regulations.[FN8] In lieu of adopting such an amendment to the CPO definition, the Committee directed the Commission to issue regulations which would have the effect of providing relief from regulation as a CPO for certain otherwise regulated entities. Specifically, the Committee Report states:

FN6 Pub. L. No. 97-444, 96 Stat. 2294 et seq. (1983).

FN7 1 See S. Rep. No. 384, 97th Cong., 2d Sess. 79-80 (1982).

FN8 The representations given in connection with the receipt of these "not a pool" letters typically stated that the entity in question (1) was subject to extensive Federal or State regulation; (2) would be using commodity interests for hedging purposes; (3) would commit only a small percentage of its assets—e.g., 5%—to its commodity interest trading; (4) would not be promoted as a commodity pool; and (5) would disclose, as appropriate, the purpose of and limitations on its commodity interest trading. See, e.g., IDS Bond Fund, Inc. (December 23, 1981); Harris Trust and Savings Bank (November 13, 1981); Montgomery Street Income Securities, Inc. (August 14, 1981).

[C]ertain entities are not within the intent of the definition of the term 'commodity pool operator', as that term is

defined in the Act, unless these entities have other attributes or features which would warrant their regulation as a commodity pool operator. Specifically, an entity regulated under the Investment Company Act of 1940 or an insurance company or a bank or trust company acting in its fiduciary capacity and subject to regulation by any State or the United States could ordinarily be excluded from the definition of the term 'commodity pool operator,' provided that (1) the entity uses commodity futures contracts or options thereon solely for hedging purposes; (2) initial margin requirements or premiums for such futures or options contracts will never be in excess of 5 percent of the fair market value of the entity's assets (in the case of an investment company) or of the assets of any trust, custodial account or other separate unit of investment for which the entity is acting as a fiduciary; (3) the entity has not been and will not be, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodities markets; and (4) the entity will disclose to each prospective participant the purpose of and limitations on the scope of the ***15869** commodity futures or commodity option trading it conducts for such participants.

Also, a defined benefit plan that is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and is insured by the Pension Benefit Guaranty Corporation, or any fiduciary thereof, ordinarily could be excluded from the definition of the term 'commodity pool operator', provided that its commodity futures (or options on futures) trading activity is solely incidental to the conduct of its business as such a plan or as a fiduciary thereof. The Committee understands that such a plan and its fiduciaries are subject to extensive regulation under ERISA. Therefore, while the Commission should retain discretion in this area, the Committee believes that, unless otherwise inappropriate, exemption by rule, regulation, or order from commodity pool operator registration and related requirements, other than antifraud provisions, should generally be granted to these classes of entities.[FN9]

> 9 S. Rep. No. 384, 97th Cong., 2d Sess. 80 (1982).

To implement this directive, on February 8, 1984 the Commission published for comment in the Federal Register proposed § 4.5, which would have made available for certain otherwise regulated persons an exemption from registration as a CPO and from the provisions of Subpart B of the Part 4 regulations.[FN10] As was noted in the preamble accompanying the proposed rule, the Commission strictly followed the language of the Committee Report in specifying the persons who would be eligible for relief under the rule, the qualifying entities for which they would be so eligible and the criteria pursuant to which such qualifiying entities would be required to be operated. Pending final action on proposed § 4.5, Commission staff received requests from and issued to such persons "no-action" letters based upon representations virtually identical to those that the proposal would have required to qualify for relief thereunder.[FN11]

> FN10 49 FR 4778.

> FN11 These letters, which were issued by the Division of Trading and Markets, stated that the Division would not recommend that the Commission take any enforcement action against the otherwise regulated persons named therein for failure to register as a CPO or to comply with the provisions of Subpart B of Part 4. See, e.g., Division of Trading and Markets Staff Interpretative Letter 84-5, Comm. Fut. L. Rep. (CCH) 22,023 (February 24, 1984); Division of Trading and Markets Staff Interpretative Letter 84-4, Comm. Fut. R. Rep. (CCH) 22,022 (February 24, 1984).

By that Federal Register release the Commission further proposed certain revisions to its rules for CPOs. Among other things, the Commission proposed: to require each person exempt from registration under existing § 4.13—i.e., the operators of family, club and small pools—to file a statement of such exemption with the Commission (proposed § 4.13(b)(1); and to prohibit CPOs from receiving income generated from pool assets other than to recover actual organizational and offering expenses (proposed § 4.20(d)).

In addition, but without specifying any proposed language, by that Federal Register release the Commission also sought comment on whether: Other persons should be exempt from regulation as a CPO; persons registered as an investment adviser ("IA") under the Investment Advisers Act of 1940 should be exempt from registration as a CTA; CPOs should be prohibited from abandoning their pools; the current format for presenting the actual past performance of CPOs, CTAs, and their principals should be revised; and financial requirements for CPOs should be adopted.

The comment period on these proposals originally was due to expire on April 9, 1984. To maximize public participation in this rulemaking process, the Commission extended the comment period to May 9, 1984.[FN12] Moreover, because certain of the proposals—e.g., proposed § 4.5—pertained to persons whose primary regulator was not the Commission and who thus might not have been aware of these proposals in time adequately to review them and to comment thereon, to obtain the participation of these persons in the rulemaking process Commission staff sent letters requesting comment to such persons' primary regulators and industry associations and to numerous committees of the American Bar Association.[FN13]

FN12 49 FR 13378 (April 4, 1984).

FN13 In all, 27 such letters were sent by the Division of Trading and Markets.

The Commission received 55 comment letters on these proposals: 5 from persons registered as a CPO; 3 from persons registered as a CTA; 8 from persons registered both as a CPO and as a CTA; 5 from persons registered as a futures commission merchant ("FCM"); 1 from a person registered both as an FCM and as a CPO; 1 from a commodity exchange; 1 from an industry-wide self-regulatory organization designated as such by the Commission; 3 from trade associations representing Commission registrants; [FN14] 1 from an international regulatory agency; 2 from Federal regulatory agencies; 1 from a State regulatory agency; 2 from persons registered as an IA; 3 from insurance companies; 1 from a bank; 2 from fiduciaries of pension plans; 6 from other trade associations; 4 from bar associations; and 6 from law firms.

FN14 In addition, 56 members of the National Association of Futures Trading Advisors sent basically identical letters in support of the comments of this trade association.

The Commission has carefully reviewed each of those comment letters. Based upon that review and its careful reconsideration of its proposals, the Commission is now adopting in § 4.5 a rule which it believes is not only responsive to the concerns of the commenters but also is consistent with the intent of the Committee Report and, thus, the Commission's regulatory objectives in this rulemaking proceeding.[FN15] As is discussed further below, the Commission also now is adopting the revisions it proposed to §§ 4.13, 4.15 and 140.93, in essentially the form as such revisions were proposed. The Commission is not at this time taking any final action on proposed § 4.20(d) or on any of the issues on which the Commission, without specifying any proposed language, also sought comment—e.g., whether the current format for presenting the actual past performance of CPOs, CTAs and their principals should be revised. The Commission does, however, intend in the near future to pro-

pose rules on these matters which, as the rules being adopted today, would reflect the Commission's review of the comments thereon and the Commission's careful reconsideration of its proposals.

> FN15 Further in this regard, and as is noted above, section 2(a)(1)(A) provides the Commission with authority to exclude from the CPO definition "such persons not within the intent of this definition."

II. Section 4.5: Exclusion for Certain Otherwise Regulated Persons From the Definition of the Term "Commodity Pool Operator"

A. The Nature of the Relief Available Under the Rule

As proposed, § 4.5 would have made available for certain otherwise regulated persons an exemption from registration as a CPO and from the provisions of Subpart B of the Part 4 regulations.[FN16] Under the proposal, then, these persons would have continued to come within the CPO definition. As is discussed more fully below, § 4.5 as adopted generally follows the same structure of the rule as proposed. The nature of the relief available under the final rule is, ***15870** however, more extensive than that which was proposed.

> FN16 As is noted above, section 4m(1) of the Act requires registration as a CPO of persons who come within the CPO definition. Among other things, the Commission's regulations which implement this requirement require the filing of registration applications and fingerprint cards and the payment of attendant registration fees. See, e.g., § 3.14, 17 CFR 3.14 (1984). As is also noted above, Subpart B prescribes certain operational, disclosure, reporting and recordkeeping requirements for CPOs. See §§ 4.20-4.23.

While virtually all of the commenters agreed with the purpose of proposed § 4.5—i.e., to eliminate duplicative and unnecessary regulatory burdens—they asserted that to meet this purpose the Commission would need to make certain modifications to the proposal. Specifically, many commenters urged the Commission to reconsider the nature of the relief to be afforded by § 4.5. They stated that to effectuate the directive of the Committee Report, such relief should provide exclusion from the CPO definition (as opposed to inclusion within the definition and exemption from registration and regulatory requirement). Certain of these commenters also contended that since the proposal as drafted would require eligible persons to concede they are CPOs, it would provide for an exemptive rule which would necessitate the acknowledgement of a regulatory status that might not, in fact, be applicable. Still other commenters contended that a rule as detailed as § 4.5 was unnecessary to effectuate the directive of the Committee Report. They argued that a brief interpretative statement issued by the Commission was all that was needed.

The Commission has carefully considered these comments and also has reconsidered its interpretation of the nature of the relief intended by the Committee Report. As a result, the Commission has adopted in § 4.5 a rule that makes available an exclusion—not merely an exemption—for certain otherwise regulated persons from the definition of the term "commodity pool operator."[FN17] Moreover, because of the nature and extent of regulatory relief being provided, the Commission believes that a rule such as § 4.5—not merely an interpretative statement—is the appropriate means by which such relief should be issued. The Commission wishes to emphasize, however, that while such otherwise regulated persons may be outside the CPO definition, they still are "persons" for the purposes of the Act and the Commission's regulations thereunder.[FN18] Thus, they remain subject to, among other things, Section 4b of the Act,[FN19] which prohibits fraudulent transactions, and Part 18 of the

regulations,[FN20] which requires certain reports to be furnished by traders in the commodity interest markets.

FN17 In furtherance of the relief from registration as a CPO contained in proposed § 4.5, the Commission also proposed to amend § 3.16(a)(4), 17 CFR 3.16(a)(4) (1984), to provide that an associated person of a person exempt from registration as a CPO and from Subpart B under § 4.5 would, likewise, be exempt from registration with the Commission. However, in light of the relief afforded in § 4.5 as adopted, it has been unnecessary for the Commission to adopt that amendment to § 3.16(a)4).

FN18 This is consistent with the language in the Senate Committee Report that relief "other than [from] antifraud provisions should generally be granted."

FN19 7 U.S.C. 6b (1982).

FN20 17 CFR Part 18 (1984).

Numerous commenters expressed concern that proposed § 4.5 appeared to provide an exclusive means for relief from regulation as a CPO. Thus, they argued, if a specified otherwise regulated person was unable to meet such criteria as the Commission decided to adopt, or if such person was not so specified, it would prima facie be a CPO. These commenters recommended that adoption of a rule such as proposed § 4.5 should provide a regulatory "safe harbor," but not the exclusive means for relief from regulation as a CPO. The Commission agrees with this recommendation, and by this Federal Register release confirms that, notwithstanding the conclusion of this rulemaking proceeding, it will expect the staff to continue to issue such interpretations of § 4.5 as may be necessary and appropriate to fulfill the purposes of the rule.[FN21]

FN21 It also should be noted that, under § 4.12, the Commissioin may exempt any person from any provision of Part 4—e.g., from any provision of § 4.5—upon a finding that "the exemption is not contrary to to the public interest and the purposes of the provision from which the exemption is sought."

The Commission also agrees with the recommendation that it clarify the effect of § 4.5 on those persons who previously have obtained relief from regulation as a CPO through, as noted above, the receipt of staff "not a pool" letters under § 4.10(d) and, subsequent to the issuance of proposed § 4.5, through the receipt of staff "no-action" letters. As is discussed below, as proposed and as adopted § 4.5(c) requires that a notice of eligibility must be filed with the Commission to claim the exclusion provided by the rule and § 4.5(d) requires that, subsequently, supplemental notices must be filed as necessary to render the notice of eligibility accurate and complete. In proposing § 4.5 the Commission stated:

As the representations given in connection with the receipt of the previously issued 'not a pool' staff interpretative letters closely parallel the representations which would be required in connection with qualifying for the exemption contained in proposed § 4.5, the Commission does not believe that it should be necessary for the recipients of such interpretative letters to, in effect, "re-submit" an application for exemption—i.e., to file an initial notice of eligibility—in the event the proposal is adopted. However, to insure that these persons (and entities) would be in compliance with the requirements of the proposed rule, the Commission intends to take the position that such persons must file supplemental notices in the event that any of the representations they previously had made to the Commission changed or that, to the extent that the proposal would require any additional representa-

tions, they were not in compliance with them. This position would ensure equal treatment of all persons claiming exemption under the rule.[FN22]

FN22 49 FR 4778, 4782-83.

Consistent with this statement, and for the reasons given therein, the Commission has determined to deem each request for a "not a pool" interpretation or a "no-action" position which did, in fact, receive such interpretation or position as a notice of eligibility properly filed under § 4.5(c).[FN23] Of course, this position assumes that a person who is the subject of such interpretation or position is complying and will continue to comply with all of the provisions of § 4.5 and, in particular, with the operating criteria of § 4.5(c)(2) discussed below.

FN23 As the Commission noted in proposing § 4.5, not all of the persons who requested such staff interpretations received them. Where one or more of the requisite representations were absent, the Division of Trading and Markets declined to issue such relief but, instead, issued certain other relief from the provisions of §§ 4.21, 4.22 and 4.23 subject to such persons' registration as a CPO. See 49 FR 4778, 4785. See also, Division of Trading and Markets Staff Interpretative Letter 84-8, Comm. Fut. L. Rep. (CCH) 22,048 (March 14, 1984).

One commenter recommended that to insure equal treatment of all persons claiming relief under § 4.5 the Commission should clarify that to the extent it adopts operating criteria less stringent than those required for receipt of a "not a pool" or a "no-action" letter, the recipients of such letters should be able to comply with such less stringent criteria. The Commission agrees with this recommendation and intends to so interpret § 4.5.

Another commenter recommended that the Commission clarify the effect of § 4.5 on the recipients of staff "no-action" letters. As this person noted, because the recipients of those letters were deemed to be CPOs, they remained subject to section 4o of the Act,[FN24] which prohibits fraudulent activities by CPOs (and by CTAs). Because § 4.5 as adopted provides an exclusion as opposed to an exemption for the persons specified therein from the CPO definition, the provisions of section 4o would not be applicable to persons who qualified for relief thereunder. Consistent with the position taken above, the Commission finds that the recipients of the staff "no-action" letters ***15871** similarly are not subject to section 4o. [FN25] Those persons would remain subject, however, to all other applicable provisions of the Act and the Commission's regulations thereunder—e.g., to section 4b of the Act and Part 18 of the regulations.

FN24 7 U.S.C. 6o (1982).

FN25 Proposed § 4.5 would have retained the applicability of § 4.41, which prescribes certain advertising standards for CPOs (and for CTAs), to persons who qualified for relief from CPO regulation. Similarly, since § 4.5 as adopted excludes persons who have qualified for relief thereunder from the COP definition, the provisions of § 4.41 would not be applicable to them.

As is noted above, § 4.5 is effective today upon its publication in the Federal Register. In this regard the Commission recognizes that, pending the completion of the § 4.5 rulemaking proceeding, there may have been uncertainty on the part of persons affected thereby as to whether, and under what criteria, they would be eligible to claim the relief from regulation as a CPO available under the final rule. In light of that uncertainty, those persons may be engaging in activities for which they now would be eligible for regulatory relief under § 4.5 as ad-

opted without having sought (and received) a “not a pool” or a “no-action” letter from Commission staff. In light of such uncertainty, and subject to continued compliance with all of the other provisions of § 4.5, the Commission has determined that it will not take any enforcement action solely for failure to register as a CPO against any such person who files a notice of eligibility as specified in § 4.5(c) within 60 days from the date hereof.

B. The Persons and Entities to Whom the Exclusion is Available

In proposing § 4.5, the Commission noted that under its regulatory framework a CPO and its pool generally must be organized as separate legal entities.[FN26] The Commission further noted that to be effective, then, any relief to be provided by § 4.5“must not only be applicable to a ‘person’ who could be deemed to be a CPO but also to the pool such person intended to operate—i.e., its ‘qualifying entity.’ ” [FN27] Accordingly, as proposed and as adopted, paragraph (a) of § 4.5 pertains to the persons who are eligible for relief under the rule and paragraph (b) pertains to the corresponding qualifying entity for which such relief is available provided, as is discussed below, that such qualifying entity is operated in a specified manner.

> FN26 See § 4.20(a) and the discussion of that regulation in 49 FR 4778, 4780. As the Commission further noted in its proposal:
> Frequently, Commission staff is called upon by members of the public to offer guidance on determining who, in fact, would be the CPO of a particular pool. In providing such guidance, the staff typically looks at such factors as who will be acting in the manner contemplated by the statutory definition of the term commodity pool operator—e.g., who will be promoting the pool by soliciting, accepting or receiving from others, property for the purpose of commodity interest trading—and who will have the authority to hire (and to fire) the pool's CTA and to select (and to change) the pool's FCM. Id.
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> FN27 Id.

In its proposal, the Commission explained that it had strictly followed the language of the Committee report in specifying the persons and the qualifying entities eligible for relief from regulation as a CPO. In response to the comments received, the Commission believes that certain clarifications, refinements and expansion of the relief are appropriate.

Prior to discussing the specific persons (and their qualifying entities) eligible for relief under § 4.5, the Commission wishes to note that, as proposed and as adopted, the scope of such relief includes the principals or employees of such persons.[FN28] One commenter on this aspect of the proposal stated that such an extension would be useful and appropriate. Other commenters, however, contended that the Commission's proposal did not extend far enough. For example, one commenter suggested that the phrase “principal or employee” be expanded to include persons who functionally, but not literally, come within such phrase. Another commenter suggested that the phrase be expanded to include “such other fiduciaries that fall within the intent” of § 4.5.

> FN28 As the Commission explained in its proposal: Since who the pool operator of a given entity would be might extend to operating officials, principals or employees, to clarify the scope of the exemption, paragraph (a) includes not only the person itself (e.g., a bank or trust company) but also “any principal or employee thereof.” Id.

In response to these two commenters, the Commission wishes to explain that in proposing and in adopting § 4.5 it has carefully followed the directive in the Committee Report that relief from regulations as a CPO under the rule be afforded to otherwise regulated persons. Whether a person such as those these commenters suggest is, in fact, otherwise regulated to the extent that the persons specified in § 4.5 are regulated remains to be determined on a case-by-case basis in the context of the particular factual situation applicable to such person. Thus, the Commission is unable to incorporate the recommendations of these commenters into § 4.5 as adopted. Consistent with its prior practice in this area and with its statement made earlier in this Federal Register release, however, the Commission invites interested persons to seek such staff determinations of the scope of the term "persons, and any principal or employee thereof" in § 4.5 as shall be necessary and appropriate to effectuate the purposes of the rule.

Registered Investment Companies. As proposed and as adopted, the first "otherwise regulated person" specified in § 4.5 is "an investment company registered as such under the Investment Company Act 1940,"[FN29] and its qualifying entity similarly is such a registered investment company. Sections 4.5 (a)(1) and (b)(1).[FN30] The comments received on these provisions of the proposed rule basically asked the Commission first to clarify whether a registered investment company's depositor, sponsor, underwriter, or IA came within the definition of the term "commodity pool operator" and, if so, then to also provide relief from regulation as a CPO for such persons equivalent to the relief to be provided for the investment company itself. The Commission does not believe that the activities in which such persons typically engage are, without more, the activities in which a CPO typically engages.[FN31] Rather, the Commission believes that such persons are outside the CPO definition and, therefore, that relief from regulation as a CPO is not necessary in order to exclude such persons from the CPO definition.[FN32] ***15872** Accordingly, the Commission has determined to adopt as proposed these provisions of § 4.5.

FN28 15 U.S.C. 80a et seq. (1982).

FN30 As is noted above, under the Commission's regulatory framework, and in particular under § 4.20(a), a CPO and its pool must be separate legal entities. Section 4.20(a) recognizes, however, that in the case of a corporation the CPO and its pool may be one and the same and, accordingly, that rule provides exemption from its requirements in the case of certain corporations—i.e., those who demonstrate to the Commission that they will be operated in a manner consistent with the purposes of the rule.

FN31 See n. 26, supra.

FN32 In issuing "no-action" letters under proposed § 4.5 Commission staff similarly had occasion to consider this issue. See, e.g., Division of Trading and Markets Staff Interpretative Letter 84-11, Comm. Fut. L. Rep. (CCH) 22,290, at 29,457 n. 5 (July 17, 1984), wherein the staff stated:

We historically have treated registered investment companies and their officers and directors as those persons subject to CPO regulation. You have requested our opinion, however, that neither the Fund's registered investment advisor * * * (the "Adviser"), nor its registered broker-dealer * * * (the "Distributor"), nor any officer, director or employee of the Adviser or Distributor is a CPO. Proposed Rule

> 4.5 does not contemplate that any such person would be a CPO. See, e.g., Rule 3.16(a)(5), which generally exempts from registration as an associated person to a CPO persons registered with the National Association of Securities Dealers as a registered representative or registered principal. 48 FR 35248 (August 3, 1983). Accordingly, we do not believe than any such opinion is necessary at this time.

The Commission also believes it necessary to clarify these provisions as they would apply to a registered series investment company where one or more portfolios thereof intend to trade commodity interests. The Commission is aware that, in the course of issuing "no-action" positions under proposed § 4.5, its staff has had occasion to consider under what circumstances relief from regulation as a CPO should be afforded to such series investment companies. Specifically, the staff issued such a "no-action" position where each portfolio that intended to trade interests met the operating criteria of the proposal and where there was separate ownership in and identities of each of the company's portfolios—regardless of whether any (other) such portfolio intended to trade commodity interests.[FN33] The Commission believes that this approach is a sound one and, accordingly, intends that § 4.5 as adopted be so applied to a registered series investment company.

> FN33 See, e.g., Division of Trading and Markets Staff Interpretative Letter 84-13, Comm. Fut. L. Rep. (CCH) 22,302 (August 1, 1984), where two of the investment company's four portfolios intended to trade commodity interests. As the staff stated therein:
> Proposed Rule 4.5 does not specifically address the instant situation—i.e., where only certain portfolios of a registered series investment company intend to engage in commodity interest transactions. However, in light of the separate ownership in and identities of the Fund's Portfolios—e.g., separate investment objectives, net asset valuation and dividend policies—we believe it consistent with the intent of proposed Rule 4.5 to treat as separate entities each of the two Portfolios that intend to engage in commodity interest trading for purposes of determining whether the criteria of the proposal have been met. Conversely, where such separate ownership and identities are not present, we might find it more consistent with proposed Rule 4.5 to aggregate all of the portfolios of a series investment fund in determining whether the criteria have been met. Id. at 29,499.
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> In issuing such "no-action" letters, the staff further expressed its belief that such a determination was particularly appropriate to the proposed "hedging" and "5%" operating criteria. As the staff explained:
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> A contrary finding would enable a Portfolio to commit 5% of the Fund's total assets for its commodity interest positions which, in turn, might enable the Portfolio to commit more assets than are necessary to hedge its own, separate actual or anticipated cash positions. Id. n. 3.

Insurance Companies. Proposed § 4.5 next proposed to provide relief from regulation as a CPO to "an insurance company subject to regulation by any State" with respect to "the assets of any trust, custodial account or other separate unit of investment for which it is acting as a fiduciary."The commenters on this proposed provision strongly took issue with it.

Specifically, these commenters asserted that the proposed provision would go far beyond the intended scope of the Committee Report by, in effect, deeming the holding of commodity interests in an insurance company's general assets as the operation of a commodity pool. As one of these commenters explained:

Life insurance companies use premiums to acquire assets such as real estate or corporate bonds, which satisfy contractual obligations under the life insurance product contract. Life insurance companies treat these contractual obligations as a liability, against which the company maintains a reserve representing the difference between the actuarially determined value of future benefits payable and future premiums receivable. Reserves are established as a way of determining or measuring the assets the company must maintain to meet its future commitments under the policies it has issued. The funds accumulated in support of these reserves are invested by the insurance company in assets that are the property of the company. Unlike some entities within the scope of the proposal's relief, contractholders of traditional life insurance products do not own any interest in the general assets of a life insurance company. As a result of this significant distinction, a life insurance company's general assets are not a pool in which policyholders participate.[FN34]

> FN34 Comment letter of the American Council of Life Insurance, p. 5 (May 9, 1984).

This commenter further explained that, while fixed insurance products constitute the vast majority of life insurance contracts, some companies offer another category of products known as variable contracts in which a contract-holder's benefit under the contract may, in part, vary in relation to the value of specifically identified assets contained in a life insurance separate account. The commenter thus reasoned that if relief from regulation as CPO—i.e., inclusion within the scope of § 4.5—was in fact necessary with respect to insurance companies, at most such relief was necessary with respect to such separate accounts.

The Commission agrees that, for the reasons provided to it, the holding of commodity interests in an insurance company's general assets should not make the insurance company a commodity pool. The Commission further believes, however, that the devoting of assets to commodity interest trading by an insurance company separate account could constitute the operation of a commodity pool. Accordingly, the Commission has adopted in § 4.5 a provision that limits the availability of the rule—and therefore the need to seek the relief provided by the rule—to the operation of insurance company separate accounts. Section 4.5(b)(2).

Financial Depository Institutions. The third group of persons for whom § 4.5 proposed to provide relief from regulation as a CPO was certain financial depository institutions as specified in the Committee Report—i.e., “a bank or trust company subject to regulation by any State or the United States” with respect to “the assets of any trust, custodial account or other separate unit of investment for which it is acting as a fiduciary.”The Commission does not agree with, and has not adopted in § 4.5, the recommendation of one commenter that relief from regulation as a CPO should be available to any federally or state regulated bank or trust company in all instances, regardless of whether such bank or trust company complied with the operating criteria proposed for all other persons and qualifying entities. Such relief would be contrary to that intended by the Committee Report. Moreover, it would provide such banks and trust companies with an unwarranted competitive advantage over those persons who do not meet the operating criteria or other requirements of § 4.5 and who therefore must register with the Commission as a CPO.

Other commenters on this portion of the Commission's proposal generally recommended that it be expanded to also make regulatory relief available to such other financial depository institutions who are regulated in a man-

ner equivalent to the persons specified in the proposal. The Commission believes this recommendation useful and appropriate and, accordingly, has incorporated it into § 4.5 as adopted. Section 4.5(a)(3). Thus, the final rule expands coverage thereunder to include such persons as federally or state regulated bank affiliates, savings institutions and U.S. branches and agencies of foreign banks.

Another commenter noted that frequently a bank or trust company will act in a fiduciary capacity without having any investment authority and that in such limited capacity it would be unable to make the representations on operating criteria proposed in the rule. Accordingly, this commenter recommended that regulatory relief be applicable with respect to accounts for which a bank or trust company serves as trustee and also has investment authority. The Commission similarly believes this recommendation has merit, ***15873** and has adopted it in the final rule. Section 4.5(b)(3).[FN35]

> FN35 1 But see n. 52 infra. The Commission is aware that certain bank affiliates have registered with the Commission, and are engaging in business as, an FCM. In this regard, the Commission wishes to make clear that the relief available under § 4.5 only is available for the otherwise regulated persons and entities specified in the rule. Thus, if an FCM—albeit a bank affiliate—intended to engage in business as a CPO, § 4.5 would be unavailable to it and registration as a CPO would be required of it. This is because the primary regulator of FCMs is the Commission. Moreover, by making § 4.5 available to such other financial depository institutions—and to all of the other persons specified in the rule—the Commission does not mean to imply that it has made any determinations regarding the propriety of trading in commodity interests by such persons in general or the particular conditions under which such trading should take place. Rather, and as is discussed more fully below, the Commission intends that any such determinations remain with, and are to be made by, such persons' "other regulator."

Pension Plans. The fourth and final person for whom the Commission proposed to provide relief from regulation as a CPO was ''a trustee or named fiduciary of a defined benefit pension plan" that is "subject to the Employee Retirement Income Security Act of 1974 ["ERISA"][FN36] and is insured by the Pension Benefit Guaranty Corporation."Based upon its evaluation of the comments received, its reconsideration of the Committee Report and its review of the definitions of the term "commodity pool operator" and "pool," the Commission has extensively revised this proposed provision.

> FN36 29 U.S.C. 1001 et seq. (1982).

The comments received on this provision not only questioned its scope, but also the need for such relief from regulation as a CPO as it would provide. Certain commenters asserted that the Commission should expressly exclude from the proposed operational criteria of § 4.5—and therefore from the definition of the term "pool" in § 4.10(d)—all pension plans subject to ERISA. The Commission does not believe that the Committee Report and the definitions of the terms "commodity pool operator" and "pool" contemplate relief of such nature and breadth. The Commission does believe, however, that certain ERISA plans merit such relief. As was explained by one commenter:

[A] non-contributory plan, i.e., one in which all contributions are solely made by an employer, can never be a commodity pool, because no funds are solicited from participants and only the employer bears the funding re-

sponsibility of the plan if there are losses. Similarly, defined benefit plans are not likely to be commodity pools, even if contributions are permitted, because such plans normally require the employer to cover losses and permit the employer to benefit from excess earnings not needed to fund the benefit.[FN37]

FN37 Comment letter of Goldman, Sachs & Co., p. 5 (May 8, 1984).

Accordingly, § 4.5 as adopted expressly excludes a noncontributory plan, whether defined benefit or defined contribution, or under certain circumstances a contributory defined benefit plan, which is covered under Title I of ERISA. Sections 4.5(a)(4)(i) and (ii). In this regard, the Commission notes that Title I contains the operative provisions of ERISA—e.g., reporting, disclosure, administration and enforcement provisions—which, for the purposes of this rulemaking, would make a pension plan "otherwise regulated." Accordingly, for these purposes, the Commission believes that coverage under Title I should be controlling.

The Commission is aware that certain contributory defined benefit plans have an "additional" feature which allows for (additional) voluntary employee contributions, the benefit from which depends on the performance of the investments into which such contributions are placed. Because this feature has "pool" attributes to it, the availability of the express exclusion in § 4.5 for a contributory defined benefit plan is subject to the proviso that "with respect to any such plan to which an employee may voluntarily contribute, no portion of an employee's contribution is committed as margin or premiums for futures or options contracts." [FN38] Section 4.5(a)(4)(ii).

FN38 To stay outside the proviso—and to maintain its exclusion from the term "pool"—such plan may seek to address this matter through segregation.

Similarly, but for other reasons, the Commission agrees with those commenters who contended that governmental pension plans are not appropriate subjects for regulation and, therefore, that they need not qualify for any exclusion from such regulation. As was stated in connection with excluding such plans from coverage under ERISA:

State and local governments must be allowed to make their own determination of the best method to protect the pension rights of municipal and state employees. These are questions of state and local sovereignty and the Federal government should not interfere.

Likewise the various retirement plans established by the Federal government would be exempt since these are regulated by other statutes.[FN39]

FN39 I Legislative History of the Employee Retirement Income Security Act of 1974, 97th Cong., 2d Sess. 224 (Comm. Print 1976).

Thus, § 4.5 as adopted also expressly provides exclusion for such governmental plans.[FN40] Section 4.5(a)(4)(iii).

FN40 Specifically, this express exclusion is applicable to "a plan defined as a governmental plan in section 3(32) of Title I" of ERISA.

Thus, §4.5 excludes each of these three types of pension plans from the definition of the term "pool" in § 4.10(d) . The Commission wishes to make clear, however, that this exclusion is only applicable at the pension plan level itself and not at any subsequent level where the assets of any such pension plan are commingled with the assets of any other person in trading commodity interests and gains and losses are not separately accounted for. For ex-

ample, in the event that the assets of two or more such plans are commingled in a trust account or other type of investment vehicle which intends to trade in, among other things, commodity interests, the Commission in appropriate cases where that vehicle was not subject to an effective exclusion under § 4.5 would deem the operation of such vehicle as the operation of a commodity pool and such plans as its pool participants. In such event, with respect to such vehicle compliance with the provisions of § 4.5—or regulation as a CPO—would be required.

With respect to other pension plans covered under Title I of ERISA—e.g., a contributory defined contribution plan, the Commission has determined to include such other plans as qualifying entities in § 4.5 and, thus, to enable the trustee or named fiduciary of any other such plan to claim the relief from regulation as a CPO available under § 4.5—subject, of course, to compliance with the provisions of the rule. Section 4.5(b)(4). The Commission believes that such relief is appropriate in light of the pervasive regulatory scheme to which such other plans are subject under Title I of ERISA.[FN41] The Commission further believes that such relief is necessary in light of the fact that in trading commodity interests such other plans would possess characteristics typical of commodity pools—e.g., contributions to such plans are made by the participants therein and the benefits to be received from such contributions depend upon the performance of the investments into which those contributions are placed.

FN41 As is noted above, Title I contains provisions concerning reporting, disclosure, administration and enforcement.

Whether any other pension plan not specified in § 4.5 merits such relief as the rule provides, or any other regulatory relief, remains to be determined on a case-by-case basis in light of the facts particular to such ***15874** plan—e.g., whether, and to what extent, the operations of such plan are subject to other regulation. As explained above, the Commission intends that its staff shall issue such determinations. The Commission further intends that, as it gains experience in this area, it will reevaluate this aspect of the rule.

The Commission emphasizes, however, that the fact that a pension plan is not covered under Title I of ERISA does not, in each and every case, make such plan a commodity pool—ineligible as a qualifying entity under § 4.5(b)(4). In this regard, the Commission notes that certain plans or arrangements, such as an Individual Retirement Account or a plan which covers only the owner of a business (and his or her spouse) are, in effect, excluded from coverage under Title I of ERISA.[FN42] By their very nature, such plans are not within the meaning and intent of the term “pool” contained in § 4.10(d), nor are their “operators” within the CPO definition contained in section 2(a)(1)(A) of the Act.[FN43]

FN42 See 29 CFR 2510.3-2(d) and 2510.3-3 (b) and (c)(1984) which concern, respectively, certain Individual Retirement Accounts and so-called “Keogh” or “H.R. 10” plans.

FN43 See Division of Trading and Markets Staff Interpretative Letter 83-9, Comm. Fut. L. Rep. (CCH) 21,909 (November 3, 1983), wherein Commission staff stated that a joint account comprised, in effect, of certain immediate family members would not be a “pool” within § 4.10(d). Cf. 43 FR 18557, 18561 (May 1, 1978), wherein the Securities and Exchange Commission interpreted the “natural person” exemption under Section 11(a)(1)(E) of the Securities and Exchange Act of 1934 as including “an individual retirement account established by

a natural person"—but not "group retirement accounts." In this regard, and also as is stated above, where the assets of a pension plan such as those specified in n. 42 are commingled with the assets of another person in trading commodity interests and gains and losses are not separately accounted for, with respect to such commingled trading vehicle compliance with § 4.5—or regulation as a CPO—would be required.

Finally, the Commission wishes to respond to those commenters who asserted that relief under § 4.5 should not be limited to "a trustee or named fiduciary" of a specified pension plan but, rather, that relief should be available to all ERISA fiduciaries of such a plan. The Commission believes that for the purposes of § 4.5 such a sweeping provision would be overly broad. While the Commission acknowledges that the fiduciary standards required of such persons are extremely high, it is not, however, persuaded that such standards make such persons "otherwise regulated" to the same extent as trustees and named fiduciaries of ERISA plans. Accordingly, the Commission has adopted as proposed the term "a trustee or named fiduciary." Section 4.5(a)(4). The Commission does, however, invite interested persons to seek staff determinations of this term as it may apply to related persons or affiliates of the persons specified therein.

C. The Notices Required to Claim and to Maintain the Exclusion

In General. The Commission's proposal would have required, initially, the filing of a notice of eligibility to claim relief from regulation as a CPO and, subsequently, the filing of such supplemental notices as would be necessary to amend the notice of eligibility so as to render it accurate and complete. The Commission disagrees with the contention of several commenters that such notices were unnecessary. In light of the nature of the relief available under § 4.5, the Commission believes that the filing of such notices are necessary and appropriate. The Commission has both the right and the obligation to know who is claiming the relief available under the rule and to have that knowledge kept current. Those commenters also contended that the proposed notices might prove unduly burdensome to the persons required to file them. Here, too, the Commission disagrees. In the preamble accompanying its proposal the Commission requested comment on whether those notices should be supported by any specific documentation and, if so, what documentation would be appropriate.[FN44] In response to that request, one commenter asserted that, in light of the antifraud standards specified by such persons' other regulators, such documentation was unnecessary. Another commenter also argued that such documentation was unnecessary in light of the Commission's proposal (adopted in § 4.5(c)(2)(v)) to require such documentation on an "as needed" basis. The Commission believes these comments have merit and is not now adopting any documentation requirement.[FN45] Moreover, as proposed and as adopted, the notice of eligibility is effective upon filing. Section 4.5(c)(4). In light of the foregoing, the Commission believes that no undue burdens will be imposed on persons seeking to claim relief under § 4.5.

FN44 49 FR 4778, 4780.

FN45 The Commission's experience with § 4.5 subsequently may indicate, however, that such documentation is necessary and appropriate for the administration of the rule.

Thus, § 4.5 as adopted requires both the filing of initial and supplemental notices to claim and to maintain exclusion from the definition of the term "commodity pool operator." Sections 4.5 (c) and (d), respectively. Specifically, the notice of eligibility must be filed with the Commission "prior to the date upon which such person in-

tends to operate the qualifying entity pursuant to the exclusion provided by this section" (§ 4.5(c)(3)) and any supplemental notice must be filed within 15 days after the occurrence of an event that renders the notice of eligibility inaccurate or incomplete (§ 4.5(d)(2)).

The Commission also has adopted as proposed certain other requirements applicable to any notice required to be filed under § 4.5—i.e., it must be in writing, signed by a duly authorized representative, and filed with the Commission. Section 4.5(f). In addition, to ensure the proper administration of § 4.5, the Commission has adopted a requirement that any such notice also must be filed, at the address specified in the rule, with the National Futures Association (the "NFA"), which now has responsibility for registering CPOs. Section 4.5(f)(4).[FN46] The one commenter on this portion of the proposal addressed the provision on duly authorized representatives and, in particular, the provision that "if such person [who files a notice] is a corporation, [the notice must be signed] by the chief executive officer, chief financial officer or counterpart thereto."That commenter contended that the provision would unnecessarily limit authorized signatories, by failing to recognize that typically corporate entities have a broader range of individuals who are authorized to sign submissions on behalf of the corporation. The Commission believes that this argument has merit and, accordingly, has adopted in the final rule the commenter's recommendation that any notice required to be filed under § 4.5 must be "signed by a duly authorized representative"—i.e., a representative who has been authorized to bind the person on whose behalf the notice has been filed to the information and the representations contained in the notice. Section 4.5(f)(2).

> FN46 Pursuant to section 17 of the Act, 7 U.S.C. 21 (1982), the Commission has designated the NFA as a registered futures association with responsibility for the regulation of persons who are required to be registered with the Commission—e.g., CPOs. See NFA Bylaw 1101. See also, NFA Compliance Rule 2-13, which provides in pertinent part that "[a]ny Member who violates any of CFTC Regulations 4.1 and 4.16 through 4.41 shall be deemed to have violated an NFA requirement."Thus, a requirement that any notice filed under § 4.5 must be filed with the NFA is necessary to ensure that this designated self-regulatory organization is timely apprised of the activities of persons who are acting as a CPO—and persons who have qualified under § 4.5 for exclusion from the CPO definition.

***15875** The Information That the Notice of Eligibility Must Contain. Subject to the exception discussed below, as proposed and as adopted the notice of eligibility must contain the name of the person claiming exclusion under § 4.5, the qualifying entity for which such exclusion is being claimed, and the applicable provisions under paragraphs (a) and (b) of the rule pursuant to which they are eligible for exclusion. Section 4.5(c)(1).

The Commission further proposed that where the qualifying entity was a registered investment company, the notice of eligibility also would contain information on any exemptions concerning disclosure and financial reporting to which the investment company was subject under the Federal securities laws or, if it was not so subject, a statement to that effect. The Commission explained that this proposal arose out of a concern that "the nature and extent of such exemptions could be such that the investment company should not be treated as an 'otherwise regulated person' for purposes of proposed § 4.5." [FN47] The two persons who commented on this proposed provision [FN48] asserted that it was unnecessary inasmuch as, among other things, an exemptive order under Section 6(c) of the Investment Company Act of 1940—to which the Commission specifically referred in the preamble accompanying its proposal—can only be issued on the basis that regulation under the specific provision from which exemptive relief is sought is not necessary for the public interest or the protection of investors. The Commission finds that this argument and others presented to it have merit and, accordingly, has not adopted its

proposed provision concerning special disclosures by registered investment companies.[FN49]

FN47 49 FR 4778, 4781.

FN48 One of these persons was the Division of Investment Management of the Securities and Exchange Commission.

FN49 In the preamble accompanying its proposal the Commission also requested comment on whether the notice of eligibility should require similar disclosure on exemptions with respect to any other qualifying entities. 49 FR 4778, 4781. The Commission did not receive any comments responsive to that request and has not adopted any such disclosure requirements in the final rule.

The other commenters on this portion of the Commission's proposal recommended clarification of the proposal as it would apply to qualifying entities of banks or trust companies. See § 4.5(c)(1)(iii). They argued that, in the case of a bank or trust company which intends to trade commodity interests on behalf of various fiduciary accounts, the provisions of the notice of eligibility could be interpreted to require inclusion of extensive lists of such accounts and to require frequent amendment as such accounts are opened and closed. The Commission does not believe that the notice of eligibility needs to be interpreted so broadly—and to impose such an administrative burden—to fulfill its purposes. One commenter recommended that a bank should be able to file a "blanket" notice which would notify the Commission that the bank serves as fiduciary for trusts the operation of which, absent qualifying for relief under § 4.5, might require the bank to register as a CPO. The Commission disagrees with this contention because, as is explained more fully above, it has the right and the obligation to know who is claiming relief under § 4.5 and the qualifying entity for which such relief is being claimed. Rather, the Commission intends to interpret the notice of eligibility to require the name of each ultimate trading vehicle through which a bank or trust company, or any other such financial depository institution, intends to trade commodity interests on behalf of various fiduciary accounts—e.g., the name of each such collective trust fund into which such accounts have been placed.[FN50] The Commission further intends that, assuming each such trading vehicle is named, the financial depository institution need only file one notice of eligibility to claim relief under § 4.5 with respect to all such trading vehicles.

FN50 See, e.g., Division of Trading and Markets Staff Interpretative Letter 84-16, Comm. Fut. L. Rep. (CCH) 22,347 (September 7, 1984).

The Representations Concerning Operating Criteria that the Notice of Eligibility Must Contain. The Commission also proposed that the notice of eligibility would be required to contain certain representations concerning the standards by which a qualifying entity would be operated with respect to its commodity interest activities. These standards—which would be the operating criteria for relief from regulation as a CPO—would have required the entity: (1) To trade commodity interests solely for bona fide hedging purposes; (2) to commit no more than 5% of its assets as margin or premiums for its commodity interest trading; (3) to not market itself as a commodity pool; (4) to disclose to its participants the purpose of and limitations on its commodity interest trading; and (5) to submit to special calls for information by the Commission. The Commission explained that, with the exception of the representation concerning special calls, these standards of operation were taken from the Committee Report. The Commission also noted that:

[A]lthough this proposal has not itself gone beyond the specific language of the Committee Report to further define the meaning and scope of these criteria, the Commission specifically is requesting comments on the actu-

al content of these representations which address specifically the differences in the other regulatory frameworks to which the qualifying entities set forth in the proposal are subject. The Commission expects that the final rules on these representations will more fully describe the parameters of such operating conditions. Moreover, the Commission would expect to interpret the express criteria of the rule in accord with the specific standards contained in the staff interpretations of § 4.10(d) which have been issued to date. Absent comment which suggests further interpretation or modification of the rule itself, the Commission expects to continue to follow such interpretations and to consider requests for further delineation of the criteria based on specific fact situations.[FN51]

FN51 44 FR 4778, 4781.

Most of the persons who commented on proposed § 4.5 addressed this portion of the Commission's proposal. The Commission has given particular attention to those comments. Thus, while the five operating criteria the Commission has adopted are essentially modeled on those originally proposed, as is discussed below the Commission has made certain fine tuning changes to them to reflect those comments consistent with the general intent of the Committee Report. Section 4.5(c)(2).

Prior to discussing each of these criteria in detail, the Commission wishes to respond to those persons who contended that the Commission should not use the Committee Report as a basis for interfering with the ability of the persons specified therein to use commodity interests in managing their investment portfolios and, further, that any limitation on such use should come from the Federal or State regulators of such persons' overall operations. Neither the proposed nor final rule limits such use. Rather, § 4.5 provides relief for those persons from certain regulation that otherwise would be required as a result of their use of the commodity interest markets. Moreover, to clarify the intent and effect of the representations on operational criteria that the notice of eligibility must contain, the Commission has adopted a proviso, which follows such representations in the rule, that the making of those representations “shall not be deemed a substitute for compliance with any criteria applicable ***15876** to commodity futures or commodity options trading established by any regulator to which such person or qualifying entity is subject.”Thus, the Commission's intent in adopting the § 4.5 criteria is to distinguish when certain entities should be treated as commodity pools and their operators as CPOs—and not to establish what should be regarded as prudent trading strategies.

Also, in response to the commenters on this portion of the proposal, the Commission wishes to make clear that, as the other information the notice of eligibility must contain, the representations on operating criteria must be made with respect to the ultimate trading vehicle through which an eligible person intends to trade commodity interests.[FN52]

FN52 1 See Division of Trading and Markets Staff Interpretative Letter 85-5, Comm. Fut. L. Rep. (CCH) 22,506 (February 28, 1985), wherein Commission staff was unable to issue the requested “no-action” position under proposed § 4.5 because the ultimate trading vehicle was unable to make each of the proposal's representations with respect to each of the underlying pooled trading vehicles. Based upon other facts presented to it, however, the staff issued certain other relief.

In this connection, the Commission notes that where trading in commodity interests by a qualifying entity is not through a pooled investment vehicle or for its own account certain other issues may arise—e.g., whether in directly receiving money for trading in commodity interests, an otherwise eligible person is acting

as an FCM.

1. The Bona Fide Hedging Representation. The first proposed representation concerning the standards by which a qualifying entity would be required to be operated was that the entity "will use commodity futures or options contracts solely for bona fide hedging purposes."In the preamble accompanying its proposal the Commission stated that it intended to interpret this representation as being controlled by the definition of the term "bone fide hedging transactions and positions" contained in § 1.3(z)(1).[FN53] The Commission explained that, among other things, this definition means:

> FN53 Section 1.3(z)(1), 17 CFR 1.3(z)(1) (1984), states:
> Bona fide hedging transactions and positions shall mean transactions or positions in a contract for future delivery on any contract market, where such transactions or positions normally represent a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel, and where they are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, and where they arise from:
>
> (i) The potential change in the value of assets which a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising,
>
> (ii) The potential change in the value of liabilities which a person owes or anticipates incurring, or
>
> (iii) The potential change in the value of services which a person provides, purchases or anticipates providing or purchasing.
>
> Notwithstanding the foregoing, no transactions or positions shall be classified as bona fide hedging for purposes of section 4a of the Act unless their purpose is to offset price risk incidental to commercial cash or spot operations and such positions are established and liquidated in an orderly manner in accordance with sound commercial practices and unless the provisions of paragraphs (z) (2) and (3) of this section and §§ 1.47 and 1.48 of the regulations have been satisfied.

[I]n using commodity futures and options contracts the qualifying entity must take into account the correlation in the fluctuations in the value of its futures or options positions relative to the value of its actual or anticipated cash position. This also means that such futures or options positions must be entered into with the intent required by § 1.3(z)(1).[FN54]

> FN54 49 FR 4778, 4781. In considering requests for a "no-action" position under proposed § 4.5, Commission staff accordingly so interpreted the bona fide hedging criterion. See, e.g., The Government Securities Series of the Hutton Investment Series Inc. (April 4, 1984), wherein the staff advised that the investment company's contemplated purchase of put options on interest rate futures contracts "to hedge a long position in the underlying futures contract" did not appear to be bona fide hedging activity. Thus, the staff issued the requested "no-action" position subject to the investment company's representation that it would not purchase

> put options for such purpose "without seeking further guidance from the Commission."See also, Colonial Tax-Exempt High Yield Trust (November 1, 1984), wherein for purposes of the requested "no-action" position the staff similarly questioned certain other contemplated uses of the commodity interest markets. As the staff stated therein:
> The Prospectus also discusses [another strategy], which we do not believe would result in "bona fide hedging transactions and positions". . . . The . . . strategy is selling tax-exempt bond futures contracts (if and when approved) and buying U.S. Government bond financial futures contracts, 'to protect against shifts in value due to over-or-under valuation of the tax-exempt bond market in relation to the taxable bond market'—i.e., an inter-market straddle position. . . . Accordingly, the position we are taking herein presumes that the Trust will not engage in [this strategy]. Page 2, n.2.

The Commission then expressed its concern that certain "anticipatory" or "long hedge" strategies might not, in fact, come within the scope of § 1.3(z)(1) and proposed to adopt a "completion" test for the commodity interests employed in such strategies to ensure that they would, in fact, come within the rule. Specifically, the Commission stated:

Where there is an anticipatory transaction but no fixed commitment to make a transaction at a later time in a physical marketing channel, the Commission is concerned that distinguishing between what is the anticipatory reduction of risk and speculation may be exceedingly difficult. This is particularly true in the case of pooled investment media where there is no independent business need generated by the commercial activities of the entity (other than the need to increase investment return) for using the commodity markets to anticipate future commitments.

Nonetheless, the Commission believes that there may be situations where it would not be economically appropriate for such an entity to complete an anticipatory hedge.[FN55] In this connection, the staff has employed an intent test to determine whether an anticipatory hedge which is not in fact followed by the purchase of the commodity—i.e., "completed"—is outside the scope of § 1.3(z)(1). Accordingly, Commission staff previously has required that to receive a "not a pool" interpretation an entity must represent that it "will use commodity futures or options contracts solely for bona fide hedging purposes" and, further, that: (1) all transactions will be entered into with the intent required by § 1.3(z)(1); and (2) a substantial majority—i.e., 75%—of all anticipatory hedge transactions entered into each year will be completed. The Commission proposes to continue to so interpret the hedging criterion for purposes of the exemption in § 4.5 but specifically requests comments on whether additional or different standards should be set forth.[FN56]

> FN55 The Commission provided the following example of such a situation:
> [I]f due to drastically changed market conditions since the purchase of a long futures contract, the cash market for the commodity subject to the contract has declined and a further decline appears likely, the purchase of the commodity at the time of offset of the contract may be prudent. 49 FR 4778, 4782 n. 15.
>
> FN56 44 FR 4778, 4781-82.

In light of the comments received in response to this request, and the Commission's further deliberations on this

proposed criterion, as adopted the first representation concerning the standards by which a qualifying entity must be operated maintains the proposed requirement that a qualifying entity "will use commodity futures or commodity options contracts solely for bona fide hedging purposes" and further, as recommended by one commenter, "within the meaning and intent of § 1.3(z)(1)." Section 4.5(c)(2)(i). In addition, as is discussed more fully below, the Commission is providing certain clarifications of the completion component of this representation. Moreover, the Commission has determined to provide an alternate criterion for certain long strategies—even though it does not regard strategies which meet this alternate test as coming within the meaning and intent of § 1.3(z)(1). Section 4.5(c)(2)(i)(A)-(C).

With respect to the bona fide hedging representation, certain commenters requested clarification of the completion requirement and, in particular, of the requirement that 75% of all anticipatory transactions be completed. One commenter stated that the proposal was unclear as to when the intent to ***15877** complete a transaction would accrue.[FN57] That commenter recommended that the requisite intent should be judged as of the date on which the transaction is entered into, rather than later when the transaction is or is not completed, and that the 75% test should be used as a general standard for later review. The Commission generally believes this recommendation useful and appropriate, and intends to so interpret the completion requirement. Another commenter stated that the proposal was unclear as to when such long transactions should be completed—e.g., within one year from the date entered into or at some indefinite time in the future. The Commission does not believe that specific time constraints need be imposed upon the completion requirement. The real test is whether the intention to complete can be substantiated—i.e., through a course of conduct. In this connection, the Commission wishes to make clear that the "bona fide hedging" representation would not be violated if a qualifying entity "rolled" its long (or short) position in a commodity interest over to another position in the same commodity interest but with an earlier or later expiration date—so long as the termination of the initial or any such subsequent (rollover) position takes place at the same time as the completing cash market transaction.

> FN57 As noted above, the "bona fide hedging" criterion requires that all transactions be entered into with the intent required by § 1.3(z)(1).

One the whole, however, the commenters took vigorous issue with the use of a specific percentage in the Commission's proposed completion test. They generally contended that this approach was unduly mechanical and unrealistic and that it could force portfolio managers to enter into imprudent transactions. Certain of those commenters recommended that the Commission should merely retain the "substantial majority" language, without attaching any specific percentage thereto. They argued that in satisfaction of this requirement, the Commission should only require a qualifying entity to document the completion of its long transactions and to explain the circumstances surrounding uncompleted transactions. As those commenters noted, Commission staff had taken this approach in issuing "not a pool" interpretations under § 4.10(d).[FN58] . The Commission notes, however, that as the staff continued to develop and to refine the representations necessary for relief from regulations as a CPO, it did require a representation that "a substantial majority—i.e., 75%—of all anticipatory transactions would be completed."[FN59] Moreover, the approach recommended by those commenters would require the Commission continuously to evaluate the use of commodity interests by each person who has claimed the regulatory relief available under § 4.5.[FN60] This would be contrary to the Commission's intent, as is noted above, that the rule alleviate the need for the Commission to make case-by-case determinations in respect to meeting the eligibility and operating criteria requirements.

> FN58 See, e.g., Division of Trading and Markets Staff Interpretative Letter 83-5, Comm. Fut. L. Rep. (CCH) 21,905 (September 13, 1983).

FN59 See, e.g., The Government Securities Series of the Hutton Investment Series Inc., supra n. 54.

FN60 Compare § 4.5(c)(2)(v), which provides authority to the Commission to make such special calls as may be necessary to demonstrate compliance with the provisions of § 4.5(c).

Other commenters questioned the applicability of the provisions of § 1.3(z)(1), and in particular the Commission's interpretation of those provisions in the context of long transactions, to the persons and qualifying entities eligible for relief from regulation as a CPO. They asserted that since § 1.3(z)(1) was developed at a time when the commodity interest markets were used to facilitate the movement of physical goods from the producer to the consumer, the rule was not written in terms applicable to portfolio managers—i.e., persons charged with maximizing returns. Thus, those commenters argued that the application of § 1.3(z)(1) is appropriate in a merchandising environment.[FN61] Many of them further recommended various alternate representations to the Commission's proposed “bona fide hedging” representation.

FN61 In this regard, those commenters compared the trading of commodity interests in a merchandising environment to such trading in a financial environment.

Although the Commission does not necessarily agree with such comments, based upon its review of those comments and of recommendations that alternate representations be considered, the Commission has provided in § 4.5(c)(2)(i) the following alternate representation that may be made with respect to long positions in a commodity future or commodity option contract:

[T]he underlying commodity value of such contract at all times will not exceed the sum of:

(A) Cash set aside in an identifiable manner, or short-term United States debt obligations or other United States dollar-denominated high quality short-term money market instruments so set aside, plus any funds deposited as margin on such contract;

(B) Cash proceeds from existing investment due in 30 days; and

(C) Accrued profits on such contract held at the futures commission merchant.

With respect to certain of the terms used in this alternate representation, the Commission believes the following explanations helpful. For a futures contract, the “underlying commodity value” is computed by multiplying the size of the contract by the daily settlement price of the contract. For an option on a futures contract, the underlying commodity value is the underlying commodity value of the number of futures contracts underlying the option. For an option on a physical commodity, the underlying commodity value is computed by multiplying the contract size by the daily cash or spot futures price of the underlying commodity. The term “high quality” refers to a determination of such a rating as shall have been made by any major rating service.

The Commission emphasizes, however, that this alternate representation is not intended to encourage or to authorize the trading of commodity interests as a replacement for trading in the corresponding cash markets. Rather, it requires that the trading of commodity interests must be incidental to a qualifying entity's activities in the underlying cash market. This representation, then, as all of the other representations on operating criteria specified in § 4.5(c)(2), is necessary to comply with the intent of the Committee Report that regulatory relief be

issued unless a person in operating a qualifying entity possesses “other attributes or features” which would warrant its regulation as a CPO. Moreover, the Commission further wishes to emphasize that in adopting this alternate representation it has not sough to disturb or to expand upon the provisions of § 1.3(z)(1) and the staff's prior interpretations of those provisions. Rather, the representation is intended to serve “as a substitute for compliance with the provisions of this paragraph.”

Finally, the Commission wishes to respond to the commenter who requested clarification on the application of the bona fide hedging requirement to the writing of commodity option contracts for yield purposes. That commenter acknowledged that such activity might not come within the meaning and intent of § 1.3(z)(1). It asserted, however, that such option writing should be permitted pursuant to guidelines that effectively would make them “covered” in substance if not in form, and thereby would, according to that commenter, provide a relatively “risk-free” service. The Commission believes that whether the writing of ***15878** commodity options is such activity as should merit relief under § 4.5 remains to be determined on a case-by-case basis in light of the facts particular to such option writing. In this connection, the Commission is aware that its staff has had occasion to make such determinations in the course of issuing “not a pool” interpretations and “no-action” positions.[FN62] Consistent with that practice, and prior statements in this preamble, the Commission invites interested persons to continue to seek such staff interpretations.

> FN62 1 See, e.g., Colonial Tax-Exempt High Yield Trust, supra n. 54, wherein Commission staff stated:
> [The Trust contemplates] writing put options on futures contracts the Trust has sold, to offset the Trust's positions in such futures contracts. Notwithstanding the fact that this strategy may not increase the Trust's risks as a participant in the commodity interest markets, it would not result in a bona fide hedging position. Moreover, this strategy cannot be considered as merely effecting an offsetting position, because such offset will only occur if and when the holder of the option exercises the option. Accordingly, the position we are taking herein presumes that the Trust will not engage in [this strategy]. Page 2, n.2.
>
> Compare, Division of Trading and Markets Staff Interpretative Letter 83-10, Comm. Fut. L. Rep. (CCH) 21,910 (November 21, 1983), wherein the staff concluded that certain option writing activity came within proposed § 4.5. As the staff stated:
>
> A critical indicia of [the] intent [required by § 1.3(z)(1)] will be the extent to which [the Fund's] commodity interest transactions are entered into for traditional hedging purposes—that is, futures contracts are sold or simultaneously put options are purchased and call options are written to protect against a decline in the value of securities that [the Fund] owns.
>
> In this connection, it appears that the commodity interest transactions in which [the Fund] intends to engage—i.e., selling stock index futures contracts or simultaneously purchasing put options and writing call options on stock index futures contracts—would place [the Fund] on the ‘short’ side of the market in such transactions. It also would appear, then, that all of [the Fund's] commodity interest transactions should in fact be entered into for traditional hedging purposes to

> maintain our conclusion that [the Fund] would not be a 'pool.'
>
> With respect to [the Fund's] proposal to simultaneously purchase put options on stock index futures contracts and to write call options on such contracts, you have represented that: (1) The contracts subject to such options, and the quantities, strike prices and expiration dates thereof, would be identical for each such option; and (2) the transactions would be executed to protect against a decline in the value of securities that [the Fund] owned. Id. at 27,938-39.

2. The 5% Limitation on Assets Representation. The second proposed representation was that the qualifying entity "will not enter into commitments which require as deposits for initial margin for [its] futures or options contracts more than 5% of the fair market value of its assets."

The Commission disagrees with those commenters who argued that neither the 5% limitation nor any other such percentage limitation was necessary or appropriate to fulfill the intent of the Committee Report. In response, the Commission notes that the limitation is suggested by the Committee Report and is intended as a bright line to distinguish between entities which should not be subject to direct Commission regulation and those which should be. As the Commission explained in its proposal, the reason for this criterion is that regulatory relief "is not intended to be for pooled media primarily dealing in commodity interest trading but for qualifying entities that use commodity interests as risk reduction transactions as an adjunct to their other stated investment activities."[FN63] Indeed, as another commenter noted, some restriction on initial commitments for commodity interests is necessary to ensure that a qualifying entity does not engage in speculation through "overhedging"—i.e., by "hedging" more than 100% of its assets—and thereby violate the first operating criterion that it will use commodity interests "solely for bona fide hedging purposes within the meaning and intent of § 1.3(z)(1)." Moreover, based on the experience of Commission staff in issuing "not a pool" and "no-action" letters and its own review of the current initial hedge margins and premiums for the commodity interest in which the Commission is aware that the persons and qualifying entities specified in § 4.5 intend to trade, the Commission believes that the 5% limitation generally should not pose any serious or regular impediments to the use of commodity interests by such persons and entities.[FN64]

> FN63 49 FR 4778, 4782.
>
> FN64 For example, with respect to the June '85 Treasury bond futures contract traded on the Chicago Board of Trade, on March 14, 1985 the initial hedge margin for the contract ($1,500) represented approximately 2.2% of the contract's market value based on that day's settlement price ($68,312.50). Similarly, with respect to the June '85 S&P 500 Index contract traded on the Chicago Mercantile Exchange, on that day the initial hedge margin for the contract ($2,500) represented approximately 2.7% of the contract's market value based on that day's settlement price ($91,150). Thus, a 5% limitation on the amount of the fair market value of a person's assets that may be committed as initial margin for its futures contracts would enable the person to enter into contracts with a market value of, in the first example, approximately 2.3 times the fair market value of its assets (5/2.2) or alternatively, in the second example approximately 1.9 times the fair market value of its assets (5/2.7). Of course, to meet and to maintain the bona fide hedging criterion, a qualifying entity may not enter into futures contracts in quantities that exceed

the relevant hedge ratio for such cash and futures market positions.

Thus, the Commission has adopted as the second operating criterion a 5% limitation on the fair market value of a qualifying entity's assets that may be committed as initial margin and premiums for the entity's commodity interest positions. Section 4.5(c)(2)(ii). The Commission has, however, adopted in the final rules two provisions concerning the computation of the 5% limitation that are intended to eliminate certain impediments to qualifying for relief from regulation as a CPO that commenters perceived in the proposal.

First, the Commission has clarified in the final rule that such 5% may not exceed the fair market value of a qualifying entity assets, "after taking into account unrealized profits and unrealized losses on any such contracts it has entered into."This provision which is consistent with generally accepted accounting principles in this area, is intended to ensure that the fair market value of the entity's assets accurately takes into account all of those assets, that the 5% limitation is and remains appropriately computed and, thus, that the entity's hedge positions may be maintained. In this regard, the Commission wishes to clarify that in determining the amount of initial margin of a commodity interest to be included in computing the 5% limitation, a qualifying entity only needs to include such amount as is required by the exchange on which such commodity interest is traded. Moreover, where a qualifying entity grants an option (whether it be a put or a call), in computing the 5% limitation it need not include the in-the-money amount of the position at the time it was established. Of course, for administrative convenience, the qualifying entity may include in its computation the amount of initial margin held at any time by the FCM through whom the commodity interest is traded—which amount must, at a minimum, equal the amount required by the exchange.[FN65] This will ***15879** eliminate the need to establish separate systems to assess continued compliance with the representation.

> FN65 1 See § 1.56(b), 17 CFR 1.56(b) (1984), which provides in pertinent part:
> No futures commission merchant * * * may in any way represent that it will, with respect to any commodity interest in any account carried by the futures commission for or on behalf of any person: * * *
>
> (3) Not call for or attempt to collect initial * * * margin as established by the rules of the applicable board of trade.
>
> In this connection, the Commission wishes to explain that initial and any subsequent margin is, in effect, set at three levels: at the clearinghouse—which generally sets original margin at a level equal to or less than exchange initial margin; at the exchange; and at the FCM—who frequently requires its customers to provide funds in excess of the minimum margin requirements set by the exchange. For the purposes of § 4.5, the Commission does not believe that the clearinghouse requirements, which are computed on a net basis in most cases, can be used. Nor does the Commission believe that, for these purposes, the FCM requirement need be controlling (as opposed to optional) since this could induce a qualifying entity to choose an FCM based on factors other than service and execution.

Second, the Commission has addressed the concerns of those commenters who asserted that where a qualifying entity purchases an option (whether a put or a call), the proposed rule failed to take into account the fact that the premium paid for the purchase of an in-the-money option may exceed the initial margin on the underlying futures contract, although the market risk may be no greater. Thus, those commenters argued that by requiring the

entire amount of option premiums to be included in computing the 5% limitation without regard to the intrinsic value of the option, the proposal would result in decisions made on other than economic—e.g., bona fide hedging—criteria. In response to those commenters, the Commission has adopted in the final rule a proviso that "in the case of an option that is in-the-money at the time of purchase, the in-the-money amount as defined in § 190.01(x) may be excluded in computing such 5%."[FN66] The Commission is aware that such computation may require detailed and difficult calculations and, accordingly emphasizes that, as indicated in the rule, the use of such computation is optional.

> FN66 Section 190.01(x), 17 CFR 190.01(x) (1984), provides that "in-the-money" means:
> (1) With respect to a call option, the amount by which the value of the physical commodity or the contract for sale of a commodity for future delivery which is the subject of the option exceeds the strike price of the option; and
>
> (2) With respect to a put option, the amount by which the value of the physical commodity or the contract for sale of a commodity for future delivery which is the subject of the option is exceeded by the strike price of the option.

The Commission also recognizes that, notwithstanding the foregoing revisions and clarifications, there may be extraordinary circumstances in which a qualifying entity which has been in compliance with the 5% limitation inadvertently exceeds the limitation. This could occur, for example, if subsequent to establishment of a commodity interest hedge position by a qualifying entity, the exchange on which such commodity interest was traded increased initial margin requirements significantly and deemed them applicable to existing as well as newly established positions.[FN67] In such circumstances, the Commission does not intend to interpret § 4.5 as requiring the forced liquidation of such positions as would be necessary to bring the qualifying entity within the 5% limitation.

> FN67 Although the higher margin levels were not required to established the qualifying entity's position in the example, they nevertheless would represent an increase in the entity's initial margin level under the circumstances hypothesized.

3. The Marketing Representation. As proposed and as adopted, the third representation is that the qualifying entity "will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures or commodity options markets." Section 4.5(c)(2)(iii). Also as proposed, the Commission intends the term "marketing" to include oral, written and electronic promotional materials and that an entity would be "marketing participations" in a manner inconsistent with the required representation if it was actively promoted as "a hybrid—e.g., a securities and a commodities—trading vehicle or as an investment vehicle in which commodity futures and options trading was particularly significant and critical to the growth of its assets, as opposed to being incidental to protecting those assets against a decline in value."[FN68] In its proposal the Commission acknowledged, however, that the other regulatory agencies to which the qualifying entity is subject may prescribe the form and content of the entity's marketing materials and therefore requested comment on whether "marketing" should be further interpreted in light of the prescriptions of such other regulatory agencies.

> FN68 49 FR 4778, 4782.

In response to that request, two commenters recommended that the Commission should allow within the market-

ing representation any promotional material required by and consistent with the policies of a qualifying entity's other Federal or State regulator. Several other commenters recommended that the Commission should distinguish between marketing a qualifying entity as a commodity pool and accurate disclosure of the entity's limited use of commodity interests. They thus recommended that the marketing representation should permit a qualifying entity to describe accurately in its sales literature the limited use of its commodity interest trading and how it believes that use will be beneficial—which, in effect, would be consistent with the disclosure representation, discussed below. The Commission agrees with those recommendations and, accordingly, intends to so interpret the marketing representation.

4. The Disclosure Representation. As proposed and as adopted, the fourth representation is that the qualifying entity "will disclose in writing to each prospective participant the purpose of and the limitations on the scope of the commodity futures and commodity options trading in which the entity intends to engage." Section 4.5(c)(2)(iv). Again, in view of the differences in the other regulatory frameworks to which the entity may be subject and, in particular, any differences in applicable disclosure requirements, the Commission requested comment on whether further specificity as to how this criterion would best be met was needed.

In response to that request, several commenters generally asserted that the disclosure representation was not appropriate for certain qualifying entities—i.e., ERISA plans and bank commingled trust funds—in light of the manner in which such entities customarily are operated and administered. In consideration of such concerns, and at the recommendation of other commenters, the Commission intends that the disclosure representation may be satisfied through inclusion of the specified information in any document which is required by the qualifying entity's other Federal or State regulator to be routinely furnished to participants or, if no such document is required to be routinely furnished, through disclosure in any instrument that is required by the other regulator to establish the entity's investment policies and objectives and which is required by such other regulator to be made available (but not specifically furnished) to the entity's participants.[FN69]

> FN69 The Commission notes that certain qualifying entities—e.g., registered investment companies—are required by their other regulators to make disclosures directly to their participants but that other qualifying entities—e.g., a commingled trust fund of a federally regulated bank—may not be subject to any such direct disclosure requirement. The Commission intends that those other entities may satisfy this representation by indirect disclosure. For example, in the case of a bank commingled trust fund that intends to trade commodity interests on behalf of the various trust accounts comprising the commingled fund, the bank only needs to make the disclosure representation to the trustee of each underlying trust account.

5. The Special Call Representation. The fifth and final representation that the Commission proposed was that the qualifying entity "will submit to such special calls as the Commission shall make of it to demonstrate compliance" with the requirements for regulatory relief specified in § 4.5. In its proposal the Commission explained the reason for this representation as follows:

***15880** The Commission believes that it must be able to readily obtain such information as may be necessary to verify compliance with the terms and conditions of the exemption and would expect to make very limited use of this special call provision. Inasmuch as proposed § 4.5 would provide for exemption from the recordkeeping requirements of § 4.23, this provision would enable the Commission upon complaint to establish whether an entity operating under the exemption was in continued compliance with the exemption criteria. It may also help the

Commission to further refine the hedging or other criteria required by the exemption or to expand such criteria by rendering data on commodity interest activity by such entities generally accessible.[FN70]

FN70 49 FR 4778, 4782.

Here also, in light of the comments received, the Commission has adopted this representation essentially in the form as proposed. Section 4.5(c)(2)(v). Moreover, in the absence of any comments received, the Commission has adopted as proposed a delegation to the Director of the Division of Trading and Markets, and to his or her designee, "all functions reserved to the Commission" under this representation. Section 140.93(a)(5).

In general, the persons commenting on the special call representation sought clarification on the nature and the manner of presentation of the information subject to such special calls. They argued that this representation should not be interpreted so as to require retroactive creation of data or to subject an entity to surprise inspections. In response to those concerns, and pursuant to the intent of the Committee Report, the Commission wishes to make clear that it does not intend to administer the special call representation in any such burdensome or onerous manner. Rather, the Commission intends that the information it would require pursuant to a special call basically would be information that the qualifying entity's other Federal or State regulator would already be requiring it to keep—e.g., data concerning the execution dates, execution prices and current values of its cash market and commodity interest positions. Moreover, as is now expressly stated in the rule, a special call would be strictly limited to documenting compliance with the information and representations on operating criteria that the notice of eligibility must contain. Therefore, the Commission believes that compliance with a special call should pose little, if any, inconvenience or disruption to the conduct of the entity's operations.

D. Termination of an Exclusion

The Commission proposed that previously effective relief from regulation as a CPO would immediately cease to be effective upon the ineligibility of the person as to whom the relief was effective or the entity for which it was effective for inclusion in paragraph (a) or (b), respectively, or upon the failure of the entity to be operated in the manner specified in paragraph (c)(2).[FN71] The Commission also proposed to terminate such previously effective relief if it determined that: (1) The notice of eligibility was inaccurate or incomplete; (2) the person or qualifying entity thereof possessed other attributes or features which would warrant regulation as a CPO; or (3) the continuance of the relief would be contrary to the public interest.

FN71 The Commission emphasized, however, that failure to provide a supplemental notice of this information under paragraph (d) would not affect the fact that the exemption had ceased and, conversely, that the providing of this information in a supplemental notice would not affect the fact that the exemption had ceased. 49 FR 4778, 4783.

The commenters generally supported the provision on immediate termination for specific grounds. They took issue, however, with such discretionary termination authority in the Commission as the proposal would have provided with respect to otherwise facially qualifying entities. They generally contended that such authority was too broad and too vague and, therefore, that it could run afoul of the Commission's intention in proposing § 4.5 by stripping the rule of reliable certainty.

Based upon its evaluation of those comments, and its existing enforcement authority under the Act,[FN72] the Commission has determined not to adopt this portion of its termination proposal. Thus, the final rule includes

only the "immediate" portion of the proposal—i.e., that an exclusion effective under § 4.5 will cease to be effective upon any change which would render the person or the qualifying entity ineligible for relief under the rule or either the representations on operating criteria inaccurate or the continuation of such representations false or misleading. Section 4.5(e). The Commission emphasizes, however, that the rule as adopted is in no way intended to preclude the Commission from exercising its enforcement authority for a violation of § 4.5—or any section of the Act or any other regulation thereunder.

FN72 See, e.g., Section 4m(1) of the Act.

II. Other Rules.

A. Section 4.13(b)(1): The Filing of a Statement by Exempt CPOs

Section 4.13 exempts the operators of essentially family, club and small pools from registration as a CPO.[FN73] Under paragraph (b)(1) of this rule, a person who qualifies for and operates pursuant to such exemption must deliver a prescribed statement to each prospective participant in its pool. This statement essentially advises the prospective participant that the CPO is not registered as such with the Commission and therefore that the CPO is not required to comply with the disclosure and reporting requirements applicable to registered CPOs under §§ 4.21 and 4.22, respectively. The statement must also describe the exemption pursuant to which the CPO is not registered.

FN73 Specifically, § 4.13(a) provides in pertinent part:
A person is not required to register under the Act as a commodity pool operator if:

(1)(i) It does not receive any compensation or other payment, directly or indirectly, for operating the pool, except reimbursement for the ordinary administrative expenses of operating the pool;

(ii) It operates only one commodity pool at any time;

(iii) It is not otherwise required to register with the Commission and is not a business affiliate of any person required to register with the Commission; and

(iv) Neither the person nor any other person involved with the pool does any advertising in connection with the pool (for purposes of this section, advertising includes the systematic solicitation of prospective participants by telephone or seminar prospective participants by telephone or seminar presentation); or

(2)(i) The total gross capital contributions it receives for units of participation in all of the pools that it operates or that it intends to operate do not in the aggregate exceed $200,000; and

(ii) None of the pools operated by it has more than 15 participants at any time.

Compare § 4.5, which makes available an exclusion from the CPO definition for the "otherwise regulated" persons specified in the rule.

In the preamble accompanying its proposal the Commission noted that § 4.13(b)(1) did not require that this pre-

scribed statement be filed with the Commission. Because it is critical to the Commission's oversight of the operations and activities of CPOs to know the identities of all persons who are acting as a CPO, the Commission proposed to amend § 4.13(b)(1) to require that the statement specified therein be filed with the Commission within seven business days after the date the statement was first delivered to a prospective participant. The Commission emphasized that this proposal was in no way intended to affect who is eligible for exemption from registration as a CPO under § 4.13 or to ***15881** delay the effectiveness of any such exemption.[FN74]

> FN74 49 FR 4778, 4784. The Commission also noted that while § 4.14 exempts certain persons from registration as a CTA, that rule does not, however, require the delivery of any prescribed statement such as that specified in § 4.13(b)(1) for CPOs. Id. n. 30.

The commenters generally supported this proposed amendment to § 4.13(b)(1). Accordingly, subject to two exceptions discussed below, the Commission has adopted the amendment as proposed.

One commenter recommended that the statement be required to be filed not later than the date that the trading activity of the pool for which the statement is required commences. According to that commenter, many CPOs who are exempt from registration under § 4.13 are not familiar with this requirement but many FCMs (voluntarily) require proof that such a statement has been furnished to the pool's participants. The commenter thus reasoned that its recommendation would further compliance with the filing requirement. The Commission finds this recommendation to be useful, and has adopted in the rule a requirement that the statement must be filed "by the earlier of seven business days after the date the statement is first delivered to a prospective participant and the date upon which the pool commences trading commodity interests."Section 4.13(b)(1)(iv). Also, for the reasons provided earlier in this Federal Register release, the Commission has adopted in the final rule a requirement that the statement must be filed with the National Futures Association, at the address specified in the rule. Section 4.13(b)(1)(iv)(B).

B. Section 4.15: Continued Applicability of Antifraud Section

The Commission also proposed to amend § 4.15 such that it would no longer subject persons exempt from registration as a CPO (or as a CTA) to the provisions of section 14 of the Act,[FN75] which essentially subjects persons who are registered with the Commission to suit in reparations. The Commission explained that this proposal was in furtherance of proposed § 4.5.[FN76] Thus, the proposed amendment to § 4.15 would have affected persons proposed to be exempted from regulation as a CPO under § 4.5 and persons (currently) exempt from registration as a CPO under existing § 4.13. The Commission did not receive any specific comments on this proposal.

> FN75 7 U.S.C. 18 (1982).
>
> FN76 1 See 49 FR 4778, 4783.

While § 4.5 as adopted makes an exclusion from the CPO definition available to such persons and therefore the provisions of Section 14 inapplicable to such persons as to whom such exclusion is effective, in light of the amendment to Section 14 made by the 1982 Act,[FN77] the Commission has determined to adopt as proposed its amendment to § 4.15. The Commission emphasizes, however, that neither the proposed nor final amendment disturbs the other provisions of § 4.15—i.e., that "section 4o of the Act shall apply to any person even though such person is exempt from registration under this Part 4, and it shall continue to be unlawful for any such per-

son to violate section 4o of the Act."Thus, § 4.15 as amended retains within the scope of Section 4o persons who are within the CPO definition but who are exempt from registration as a CPO under § 4.13.

FN77 In this regard, the Commission does not intend hereafter to exercise jurisdiction in its reparations program over persons exempt from CTA registration under section 4m(1) of the Act. This view is consistent with the thrust of the 1982 amendments to the Act. See Pub. L. No. 97-444, § 231, 96 Stat. 2319-20 (1983), which generally narrowed the scope of Section 14 jurisdiction to persons registered with the Commission.

III. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act ("FRA") [FN78] requires that agencies, in proposing rules, consider the impact of those rules on small business. As the Commission noted in the preamble to the proposed rules,[FN79] it already had established certain definitions of "small entities" to be used by the Commission in evaluating the impact of its rules on such small entities in accordance with the RFA.[FN80]

FN78 5 U.S.C. 601 et seq. (1982).

FN79 See 49 FR 4778, 4787 for the Commission's discussion of the application of the RFA to proposed §§ 4.5 and 4.13(b)(1).

FN80 47 FR 18618-21 (April 30, 1982).

As the Commission also noted, those definitions do not address the persons and qualifying entities set forth in proposed § 4.5 because, by the very nature of the proposal, the operations and activities of such persons and entities generally are regulated by Federal and State authorities other than the Commission.[FN81] Assuming, arguendo, that such persons and entities would be "small entities" for purposes of the RFA, the Commission expressed its belief that proposed § 4.5 would not have a significant economic impact on them because it merely would require the filing of a notice with the Commission, the documentation for which should be pre-existing. Moreover, the Commission noted that the proposal would relieve those persons (and entities) from the requirement to register as a CPO and from the disclosure, reporting and recordkeeping requirements applicable to registered CPOs.[FN82] Thus, the Commission concluded that no economic analysis of proposed § 4.5 was required.

FN81 For example, a registered investment company is regulated by the Securities and Exchange Commission.

FN82 As is explained more fully above, § 4.5 as adopted makes even greater relief available to such persons and entities.

With respect to § 4.13(b)(1), the Commission explained that it previously had determined that registered CPOs are not small entities for purposes of the RFA [FN83] and, therefore, that an economic analysis of § 4.13(b)(1) —which would apply to persons exempt from registration as a CPO—might be required. The Commission similarly expressed its belief that the proposal should not have a significant economic impact on such exempt CPOs because it would merely require those CPOs to provide the Commission with an already required statement of

exemption.

FN83 47 FR 18619-20.

In certifying pursuant to Section 3(a) of the RFA that these two proposals, if adopted, would not have a significant economic impact on a substantial number of small entities, the Commission invited comments from any CPO who believed that the proposals, if adopted, would have a significant economic impact on their activities.[FN84] No such comments were received on the proposed amendment to § 4.13(b)(1).

FN84 With respect to the other two rules it is adopting today, the Commission believes that a specific RFA analysis is unnecessary. This is because § 140.93(a)(5) delegates to the Director of the Division of Trading and Markets certain authority set forth in § 4.5 and thus is covered under the RFA analysis of that rule, and the amendment to § 4.15 excludes from suit in reparations CPOs (and CTAs) who are not registered with the Commission.

Such comments were, however, received on proposed § 4.5 and, in particular, on the operating criteria proposed in the rule. In response, and as is discussed more fully above, the Commission notes that when compared to the proposed rule, the final rule: (1) makes available an exclusion from the CPO definition, not merely an exemption from regulation as a CPO as was proposed; (2) makes the exclusion available to more persons; and (3) contains various provisions—and by this Federal Register release numerous interpretations thereof—responsive to the concerns of the commenters. With respect to the operating criteria in particular, the Commission has adopted in the final rule certain provisions—and by this release interpretations thereof—intended to relieve the burdens the ***15882** commenters perceived on the availability of § 4.5—e.g., §§ 4.5(c)(2)(i) and (ii). As is stated above, § 4.5 is not intended to interfee with the business activities of the persons and qualifying entities specified therein but to provide relief from certain regulation that otherwise would be required as a result of their use of the commodity interest markets. Thus, the Commission here repeats that its intent in adopting § 4.5 is to distinguish between when certain entities should be treated as commodity pools and their operators as CPOs—and not to establish what should be regarded as prudent trading strategies.

B. Section 15 of the Act

Section 15 of the Act [FN85] requires the Commission to—

FN85 7 U.S.C. 19 (1982).

Take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives of this Act, as well as the policies and purposes of this Act, in issuing any order or adopting any Commission rule or regulation. * * *

The Commission has taken into consideration the public interest to be protected by the antitrust laws and has endeavored to take the least anticompetitive means of achieving the regulatory objectives of the Act. To the extent the rules adopted herein raise competitive concerns, the Commission has determined that such rules are necessary and appropriate. This is particularly true in light of the nature and extent of regulatory relief available under § 4.5. Moreover, in adopting § 4.5 the Commission specifically has taken into account the differences in the structures of eligible persons' and qualifying entities' “other regulators.” See, e.g., § 4.5(c)(2)(iv). As for other persons and entities, the Commission notes that, as is discussed above, while it closely has followed the Com-

mittee Report in specifying the persons and entities covered under § 4.5 it intends that the staff will continue to issue interpretations of the rule—such that, under appropriate circumstances, relief from regulation as a CPO may be afforded to such other persons with respect to such other entities.

C. Paperwork Reduction Act

The Commission previously has submitted pertinent portions of these rules to the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1980.[FN86]

FN86 44 U.S.C. Chapter 35 (1982). The control number for Part 4 is 3038-0005.

D. Effective Dates

The Administrative Procedure Act generally requires that rules promulgated by an agency may not be made effective less than 30 days after publication except for, among other things, "a substantive rule which grants or recognizes an exemption or relieves a restriction" or "for good cause."[FN87] Inasmuch as § 4.5 and the amendment to § 4.15 come within the first exception, the Commission is making these rules effective upon the date of publication of this Federal Register release. As is explained more fully above, however, by this Federal Register release the Commission also, in effect, is providing a 60 day "no-action" period for persons to file the requisite notice of eligibility necessary to claim the relief available under § 4.5. Since § 140.93(a)(5) necessarily flows from the adoption of § 4.5, the Commission finds that good cause exists similarly to make this rule effective upon publication. The amendment to § 4.13(b)(1) does not come within any such exception and, accordingly, it is to be effective 30 days after publication.

FN87 5 U.S.C. 553(d)(1) and (3)(1982), respectively.

List of Subjects

17 CFR Part 4

Commodity pool operators, Commodity trading advisors, Commodity futures.

17 CFR Part 140

Authority delegations (Government agencies), Commodity futures.

In consideration of the foregoing and pursuant to the authority contained in the Commodity Exchange Act and, in particular, sections 2(a)(1), 4k, 4l, 4m, 4n, 4o, 8a and 14 thereof, 7 U.S.C. 2, 6k, 6l, 6m, 6n, 6o, 12a and 18 (1982), and in 5 U.S.C. 552 and 552b (1982), the Commission hereby amends Chapter I of Title 17 of the Code of Federal Regulations as follows:

PART 4—COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS17 CFR § 4.5

1. Section 4.5 is added to read as follows:

17 CFR § 4.5

§ 4.5 Exclusion for certain otherwise regulated persons from the definition of the term "commodity pool operator."

(a) Subject to compliance with the provisions of this section, the following persons, and any principal or employee thereof, shall be excluded from the definition of the term “commodity pool operator” with respect to the operation of a qualifying entity specified in paragraph (b) of this section:

(1) An investment company registered as such under the Investment Company Act of 1940;

(2) An insurance company subject to regulation by any State;

(3) A bank, trust company or any other such financial depository institution subject to regulation by any State or the United States; and

(4) A trustee or named fiduciary of a pension plan that is subject to Title I of the Employee Retirement Income Security Act of 1974; Provided, however, That for purposes of this § 4.5 the following pension plans shall not be construed to be pools:

(i) A noncontributory plan, whether defined benefit or defined contribution, covered under Title I of the Employee Retirement Income Security Act of 1974;

(ii) A contributory defined benefit plan covered under Title IV of the Employee Retirement Income Security Act of 1974; Provided, however, That with respect to any such plan to which an employee may voluntarily contribute, no portion of an employee's contribution is committed as margin or premiums for futures or options contracts; and

(iii) A plan defined as a governmental plan in Section 3(32) of Title I of the Employee Retirement Income Security Act of 1974.

(b) For the purposes of this section, the term “qualifying entity” means:

(1) With respect to any person specified in paragraph (a)(1) of this section, an investment company registered as such under the Investment Company Act of 1940;

(2) With respect to any person specified in paragraph (a)(2) of this section, a separate account established and maintained or offered by an insurance company pursuant to the laws of any State or territory of the United States, under which income gains and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account, without regard to other income, gains, or losses of the insurance company;

(3) With respect to any person specified in paragraph (a)(3) of this section, the assets of any trust, custodial account or other separate unit of investment for which it is acting as a fiduciary and for which it is vested with investment authority; and

(4) With respect to any person specified in paragraph (a)(4) of this section, and subject to the proviso thereof, a pension plan that is subject to Title I of the Employee Retirement ***15883** Income Security Act of 1974; Provided, however, That such entity will be operated in the manner specified in paragraph (c)(2) of this section.

(c) Any person who desires to claim the exclusion provided by this section shall file with the Commission a notice of eligibility.

(1) The notice of eligibility must contain the following information:

(i) The name of such person;

(ii) The applicable subparagraph of paragraph (a) of this section pursuant to which such person is claiming exclusion;

(iii) The name of the qualifying entity which such person intends to operate pursuant to the exclusion; and

(iv) The applicable subparagraph of section paragraph (b) of this pursuant to which such entity is a qualifying entity.

(2) The notice of eligibility must contain representations that such person will operate the qualifying entity specified therein in a manner such that the qualifying entity:

(i) Will use commodity futures or commodity options contracts solely for bona fide hedging purposes within the meaning and intent of § 1.3(z)(1); Provided, however, That in the alternative, with respect to each long position in a commodity future or commodity option contract which will be used as part of a portfolio management strategy and which is incidental to a qualifying entity's activities in the underlying cash market but would not come within the meaning and intent of § 1.3(z)(1), as a substitute for compliance with this paragraph (c)(2)(i) a qualifying entity may represent that the underlying commodity value of such contract at all times will not exceed the sum of:

(A) Cash set aside in an identifiable manner, or short-term United States debt obligations or other United States dollar-denominated high quality short-term money market instruments so set aside, plus any funds deposited as margin on such contract;

(B) Cash proceeds from existing investments due in 30 days; and

(C) Accrued profits on such contract held at the futures commission merchant.

(ii) Will not enter into commodity futures and commodity options contracts for which the aggregate initial margin and premiums exceed 5 percent of the fair market value of the entity's assets, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into; Provided, however, That in the case of an option that is in-the-money at the time of purchase, the in-the-money amount as defined in § 190.01(x) may be excluded in computing such 5%;

(iii) Will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures or commodity options markets;

(iv) Will disclose in writing to each prospective participant the purpose of and the limitations on the scope of the commodity futures and commodity options trading in which the entity intends to engage; and

(v) Will submit to such special calls as the Commission may make to require the qualifying entity to demonstrate compliance with the provisions of this § 4.5(c);

Provided, however, That the making of such representations shall not be deemed a substitute for compliance with any criteria applicable to commodity futures or commodity options trading established by any regulator to

which such person or qualifying entity is subject.

(3) The notice of eligibility must be filed with the Commission prior to the date upon which such person intends to operate the qualifying entity pursuant to the exclusion provided by this section.

(4) The notice of eligibility shall be effective upon filing.

(d)(1) Each person who has claimed exclusion hereunder must, in the event that any of the information contained or representations made in the notice of eligibility becomes inaccurate or incomplete, file a supplemental notice with the Commission to that effect which, if applicable, includes such amendments as may be necessary to render the notice of eligibility accurate and complete.

(2) The supplemental notice required by paragraph (d)(1) of this section shall be filed within fifteen business days after the occurrence of such event.

(e) An exclusion claimed hereunder shall cease to be effective upon any change which would render:

(1) A person as to whom such exclusion has been claimed ineligible under paragraph (a) of this section;

(2) The entity for which such exclusion has been claimed ineligible under paragraph (b) of this section; or

(3) Either the representations made pursuant to paragraph (c)(2) of this section inaccurate or the continuation of such representations false or misleading.

(f) Any notice required to be filed hereunder must be:

(1) In writing;

(2) Signed by a duly authorized representative of a person specified in paragraph (a) of this section;

(3) Filed with the Commission at the address specified in § 4.2; and

(4) Filed with the National Futures Association at its headquarters office (Attn: Director of Compliance, Compliance Department).

17 CFR § 4.13

2. Section 4.13 is amended by revising paragraph (b)(1) to read as follows:

17 CFR § 4.13

§ 4.13 Exemption from registration as a commodity pool operator.

* * * * *

(b)(1) No person who is exempt from registration as a commodity pool operator under paragraph (a)(1) or (a)(2) of this section and who is not registered as such pursuant to that exemption may, directly or indirectly, solicit, accept or receive funds, securities or other property from any prospective participant in a pool that it operates or that it intends to operate unless, on or before the date it engages in that activity, the person delivers or causes to be delivered to the prospective participant a written statement that must disclose this fact as follows: “The com-

modity pool operator of this pool is not required to register, and has not registered, with the Commodity Futures Trading Commission. Therefore, unlike a registered commodity pool operator, this commodity pool operator is not required by the Commission to furnish a Disclosure Document, periodic Account Statements, and an Annual Report to participants in the pool."The person must:

(i) Describe in the statement the exemption pursuant to which it is not registered as a commodity pool operator;

(ii) Provide its name, main business address and main business telephone number on the statement;

(iii) Manually sign the statement as follows: if such person is a corporation, by the chief executive officer, chief financial officer or counterpart thereto; if a partnership, by a general partner; and if a sole proprietorship, by the sole proprietor; and

(iv) By the earlier of seven business days after the date the statement is first delivered to a prospective participant and the date upon which the pool commences trading in commodity interests:

(A) File two copies of the statement with the Commission at the address specified in § 4.2; and

(B) File one copy of the statement with the National Futures Association at its headquarters office (Attn: Director of Compliance, Compliance Department).

* * * * *

17 CFR § 4.15

3. Section 4.15 is revised to read as follows:

17 CFR § 4.15

***15884** § 4.15 Continued applicability of antifraud section.

The provisions of section 4o of the Act shall apply to any person even though such person is exempt from registration under this Part 4, and it shall continue to be unlawful for any such person to violate section 4o of the Act.

PART 140—ORGANIZATION, FUNCTIONS AND PROCEDURES OF THE COMMISSION17 CFR § 140.93

4. Section 140.93 is amended by adding paragraph (a)(5) to read as follows:

17 CFR § 140.93

§ 140.93 Delegation of Authority to the Director of the Division of Trading and Markets.

(a) * * *

(5) All functions reserved to the Commission in § 4.5(c)(2)(v) of this Chapter.

* * * * *

Issued in Washington, D.C., on April 17, 1985, by the Commission.

Jean A. Webb,

Secretary of the Commission.

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