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COMMODITY FUTURES TRADING COMMISSION

2033 K Street, NW, Washington, DC 20581

(202) 254 - 8955

(202) 254 - 8010 Facsimile



DIVISION OF  
TRADING AND MARKETS

October 11, 1994

Re: Rule 3.12(a) and Section 4k: Request for Relief from  
Associated Person Registration

Dear :

This is in response to your letter dated June 16, 1994, to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by memorandum dated August 4, 1994, and telephone conversations with Division staff. By your letter you request on behalf of "W" relief from the associated person ("AP") registration requirements of Rule 3.12(a)<sup>1/</sup> and Section 4k of the Commodity Exchange Act (the "Act")<sup>2/</sup> for "A", "W's" Chief Operating Officer.

Based upon the representations made in your letter, we understand that the facts are as follows. "W" was formed in 1985 and is a wholly-owned subsidiary of "X". Its principal activities relate to securities investment advisory and portfolio management services, custody services and the administration of trusts and decedents' estates. As of April 30, 1994, "W"'s stated equity (consisting of capital stock, retained earnings and surplus) was \$3.7 million; its revenue for 1993 was \$5,023,000 and its projected revenue for 1994 is approximately \$5,150,000. "W" currently has 21 officers and employees.

"W" seeks to expand its money management activities to include commodity interests, and its application for registration as a commodity pool operator ("CPO") and commodity trading advisor ("CTA") was filed with the National Futures Association ("NFA") on or about July 13, 1994. The proposed expansion of business will involve the management of various funds and possibly managed accounts. Interests in the funds will be offered in a manner exempt from registration under the Securities Act of 1933 and it is contemplated that all prospective participants in the funds would

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

<sup>2/</sup> 7 U.S.C. § 1 et seq. (1988 & Supp. IV 1992).

be "qualified eligible participants" ("QEPs") pursuant to Rule 4.7(a)(1)(ii) and the managed account clients would be "qualified eligible clients" ("QECs") pursuant to Rule 4.7(b)(1)(ii). It is contemplated that the funds and accounts will include mixed securities/commodities funds and accounts and, possibly, "pure" commodity pools and accounts.

"W" intends to register "B", Executive Vice President of "W" as an AP of "W" and to list "B" as a principal in connection with "W's" pending CPO/CTA registration application. "B" is currently registered as an AP and listed as a principal of "Z", which is a registered CPO and CTA, a subsidiary of "Y" and an affiliate of "W". You represent that "B" will have direct control over the activities of "W" as they relate to "W's" commodity interest related activities and will have the sole and final authority to supervise persons who solicit or accept customers or customer orders for such purposes, including the authority to hire and fire persons so engaged. You are requesting relief from the requirement to register as an AP on behalf of "A", "W's" Chief Operating Officer. You represent that although "A" is senior in the company to "B", he will not be involved in the commodity interest related activities of "W". You state that "A" will be listed as a principal of "W".

In support of your request, you make the following representations: (1) neither "W" nor "B" is subject to a pending proceeding brought by the Commission or a self-regulatory organization alleging fraud or failure to supervise, in accordance with the Act, Commission regulations or the rules of a self-regulatory organization, nor has either been found in such a proceeding to have committed fraud or failed to supervise; (2) "B" and "A" will be listed as principals of "W"; (3) neither "B" nor "A" is subject to a statutory disqualification under Section 8a(2) or 8a(3) of the Act;<sup>3/</sup> and (4) "W's" board of directors will adopt, and file with NFA, resolutions which represent and state that: (a) "A" is not authorized to solicit or accept customers' or leverage customers' orders, solicit a client's or prospective client's discretionary account, solicit funds, securities or property for a participation in a commodity pool, or exercise line supervisory authority over those persons so engaged; (b) "A" has no authority with respect to hiring, firing or other personnel matters involving persons engaged in activities subject to regulation under the Act; (c) "B", who is registered as an AP and is not subject to a pending proceeding brought by the Commission or a self-regulatory organization alleging fraud or failure to supervise, and has not been found in such a proceeding to have committed fraud or failed to supervise, as required by the Act, the rules promulgated thereunder or the rules of a self-regulatory organization, will hold and exercise full and final supervisory authority, including authority to hire

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<sup>3/</sup> 7 U.S.C. § 12a(2) or 12(a)(3) (1988 & Supp. IV 1992).

and fire personnel, over the customer commodity interest related activities of "W"; and (d) if "B" ceases to have such authority, "W" will notify NFA within twenty days of such occurrence by means of a subsequent resolution which resolution will include the name of another associated person(s) who has been vested with full supervisory authority, including authority to hire and fire personnel, over the customer commodity interest related activities of "W" in the event that all of those previously designated have been relieved of such authority.

As interpreted by the Commission, Section 4k(1) of the Act requires registration as an AP of all persons in the line of supervisory authority over the APs who solicit and accept customers' orders, including positions up through that of the firm's chief operating officer.<sup>4/</sup> Rule 3.12(h)(1)(iii) provides an exemption from associated person registration for the chief operating officer, general partner or other person in the supervisory chain-of-command where, among other things, the firm engages in commodity interest related activities for customers as no more than ten percent of its total revenue on an annual basis (the "Ten Percent Revenue Limitation"), provided that certain other conditions are met. You represent that "W", "B" and "A" will meet each of the exemption requirements of Rule 3.12(h)(1)(iii) except the Ten Percent Revenue Limitation. You state that the reason that "W" cannot represent that it will meet the Ten Percent Revenue Limitation is because "W"'s commodity interest related activities will be a new business for "W" and thus it cannot predict with any degree of certainty the percentage of the company's revenue that the commodity business will generate as compared to its other businesses of securities investment advisory and portfolio management services, custody services and the administration of trusts and decedents' estates.

With respect to the Ten Percent Revenue Limitation, we note that revenues derived from commodity pools must be considered revenues from commodity interest related activities even though the commodity pools in question may be engaged in securities transactions or other types of activities in addition to futures trading. This result follows from the fact that under our regulatory structure, the commodity pool operator is responsible for all activities of the pool and has duties under the Commodity Exchange Act and Commission regulations relevant to all such activities. Therefore, the Division considers any revenue derived by "W" from commodity pool activities, including all of the incentive fees and

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<sup>4/</sup> See Interpretative Statement Regarding the Scope of the Term "Supervision" in the Associated Person Registration Requirement, 45 Fed. Reg. 54032 (Aug. 14, 1980). Although this statement applied originally only to APs of future commission merchants, the only category of AP then in existence, it has been extended to other categories of APs subsequently created under the Act.

management fees, as commodity interest related revenues from customers for purposes of the Ten Percent Revenue Limitation, irrespective of the amount of "pure" futures trading undertaken.

In light of the fact that "W" cannot yet determine whether its revenues will comply with the Ten Percent Revenue Limitation, and subject to the conditions set forth below, the Division will not recommend that the Commission take any enforcement action against "W" or "A" for the failure of "A" to register as an AP of "W". This no-action position is conditioned upon: (1) compliance with all of the conditions of Rule 3.12(h)(1)(iii) except the requirement of the representation that "W's" commodity interest related activities for customers will not exceed the Ten Percent Revenue Limitation; and (2) "W" confirming with NFA, annually as of the anniversary of the date when it begins engaging in commodity interest related activities for customers, that it meets the Ten Percent Revenue Limitation requirement of Rule 3.12(h)(1)(iii); if "W" does not meet such requirement, this no-action position will no longer be applicable and "A's" registration, or a subsequent request for relief from registration, will be required.<sup>5/</sup> This no-action position will become applicable upon the effectiveness of "W's" registration as a CPO and CTA.

We note that this letter relieves "A" solely from the registration requirements of Section 4k of the Act and Rule 3.12(a) and does not excuse "W" or "A" from compliance with any other applicable requirements contained in the Act or the regulations

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<sup>5/</sup> With respect to the Ten Percent Revenue Limitation, the Division notes that it is a firm's responsibility to recalculate on an annual basis, the percentage of its revenues that is derived from its customer commodity interest related activities. As the Commission stated when it proposed Rule 3.12(h)(1)(iii):

the percentage of business devoted to commodity interest related activities must be reevaluated by a firm on an annual basis in accordance with the annual update of its registration form, and if circumstances have changed, e.g., that percentage now exceeds ten percent, the exemption would no longer be applicable and registration would be required. It is part of a firm's general supervisory duties to monitor this situation and any other aspects of its operations affecting registration so as to ensure that those persons whose status and activities require registration under the Act are properly registered.

promulgated thereunder. For example, each remains subject to the antifraud provisions of Section 40 of the Act<sup>6/</sup> and to all other requirements applicable to CPOs, CTAs and APs thereof. Further, the relief issued herein is applicable solely in connection with the AP registration requirement applicable to "A" as the Chief Operating Officer of "W" and, as noted, will terminate in the event that an annual review reveals that the Ten Percent Revenue Limitation has not been met.

This letter is based upon the representations made to us and is subject to compliance with the conditions stated above. Any different, changed or omitted facts or circumstances might require us to reach a different conclusion. In this connection, we request that you notify us immediately in the event the operations of "W" or the activities or responsibilities of "A" or "B" change in any way from those as represented. Further, the position taken herein represents the views of this Division only and does not necessarily represent the views of the Commission or of any other office or division of the Commission.

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

Very truly yours,

Susan C. Ervin  
Chief Counsel

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<sup>6/</sup> 7 U.S.C. § 60 (1988).