

MEMO# 4225

November 2, 1992

CFTC PROPOSES AMENDMENTS TO RULE 4.5

November 2, 1992 TO: CLOSED-END FUND COMMITTEE NO. 27-92 INVESTMENT ADVISERS COMMITTEE NO. 38-92 SEC RULES COMMITTEE NO. 83-92 RE: CFTC PROPOSES AMENDMENTS TO RULE 4.5 _____

The Commodity Futures Trading Commission ("CFTC") has proposed amendments to Rule 4.5 under the Commodity Exchange Act that would expand the range of futures and options transactions that certain persons, including investment companies and investment advisers, could engage in without having to register as commodity pool operators with the CFTC. The Institute sent a letter to the CFTC last January recommending changes to Rule 4.5 along these lines. A copy of the amendments proposed by the CFTC is attached. According to the proposing release, the amendments are intended to provide "a more 'strategy neutral' way of accomplishing the objectives" of Rule 4.5. Rule 4.5 currently provides an exclusion for otherwise regulated entities listed in the rule from the definition of the term "commodity pool operator" under specified conditions. Among other things, to qualify for the exclusion, an entity must file a notice of eligibility with the CFTC containing a representation that the entity will use commodity futures or commodity option contracts solely for "bona fide hedging" purposes (as that term is defined in CFTC Rule 1.3(z)(1)). Alternatively, a qualifying entity is permitted to use long futures or options positions which are not bona fide hedging positions if the entity represents that the value of the commodities underlying those positions is covered by cash or cash equivalents and the positions are incidental to a qualifying entity's activities in the underlying cash market (the "alternative test"). The proposed amendments would expand the alternative test to permit a qualified entity to enter into commodity futures or options positions that are neither bona fide hedging positions nor incidental to the entity's activities in the underlying cash market, provided that the gross market exposure collectively attained through such positions does not predominate the total market exposure of its portfolio. (Also, the word "long" would be deleted from the alternative test.) In addition, the proposed amendments would modify a provision under current Rule 4.5 that requires a representation that the entity will not enter into commodity futures and commodity options contracts for which the aggregate initial margin and premiums exceed 5% 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). Specifically, the proposed amendments would provide that margins and premiums on bona fide hedging positions are excluded from the 5% limit. Comments on the proposed amendments must be filed with the CFTC by December 4. If there are issues you would like the Institute to consider addressing in its comment letter, please call me at (202) 955-3514 by Monday, November 23. Frances M. Stadler Assistant Counsel Attachment

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