

**CFTC Letter No. 02-07**

**January 24, 2002**

**No-Action**

**Division of Trading and Markets**

Re: Section 4m(1); Request for Relief from Registration as a CPO

Section 4m(1); Request for Confirmation of Availability of Exemption from CTA Registration

Dear:

This is in response to your letter to the Division of Trading and Markets (the "Division") of the Commodity Futures Trading Commission ("Commission") dated November 5, 2001, as supplemented by your letter dated November 19, 2001, your e-mail sent November 27, 2001, the e-mail of your associate, "A" sent December 13, 2001 and telephone conversations with Division staff, wherein you request on behalf of "P" and "Q" relief from registration as a commodity pool operator ("CPO") under Section 4m(1) of the Commodity Exchange Act (the "Act").<sup>[1]</sup> You also request confirmation that "R" may claim exemption from registration as a commodity trading advisory ("CTA") under Section 4m(1) of the Act.

Based upon the representations you made in your correspondence, the Division understands the facts to be as follows: "P" was formed in 1994 (as a successor to a limited partnership formed in 1990) to invest funds from various members of the "S" and "T" families in a variety of securities products. The primary tie for purposes of this request is that "S" is the nephew of "T", who is "S's" maternal uncle, and "S's" cousins are investors with "S" and certain family trusts. Since the early 1970s, "S" has invested on behalf of himself and his children in a wide variety of products, which have a current value in excess of \$50 million. "T" has invested his family's funds with "S" since the 1970s. Until "T's" death, he was a director and general counsel of "U" and a director of "V". His widow and children have assets in excess of \$15 million.

The general partner of "P" (the "General Partner") is "W", which is owned by entities that themselves are owned and controlled by the "S" and "T" families. It does not receive any compensation. The limited partners of "P" include ten members of the "S" and "T" families, of whom five are individual "S" and "T" family members and five are trusts set up by members of the "S" and "T" families for their benefit or for the benefit of their descendents.<sup>[2]</sup>

More recently, in 1998, the "Company" was established to enable the "S" and "T" families to trade derivative and commodity interest products. The Company's managing members are "P" and "Q". "P" does not receive any compensation for serving as a managing member of The Company but, as is explained below, the Division believes that "Q" does.

"Q" was employed by "S" from 1975 to 1990 as a personal assistant involved in all aspects of his and his

family's financial dealings<sup>[3]</sup> and from 1999 to the present she has been the manager of an office dedicated to the equity and commodity interest trading portion of "S's" family's assets. "Q" also is a trustee of two "S" family trusts that are limited partners of "P" as well as members of the Company. In support of the instant request, you represent that "Q" is not subject to a statutory disqualification from registration under Section 8a(2) or 8a(3) of the Act.<sup>[4]</sup> The Company's other membership interests are held by essentially the same persons as hold ownership interests in "P". Specifically, these Members are five members of the "S" and "T" families (the same five as the partners in "P") and seven family trusts of the "S" and "T" families (five of which are the same as the partners in "P").

Thus, "P" and the Company "are backed exclusively by funds from the above- described ten or twelve partners or members, as the case may be. The pooling of family assets is intended to allow the partners and members to receive the benefit of certain investment opportunities without the necessity of each partner or member seeking to identify each of the opportunities and separately to analyze the merits of each."

"R" was established in 1990 to function as a service company for "P" and, subsequently, for the Company. It provides administrative services and qualified personnel to "P" and the Company. "R" is financed solely by "P" and its common stock is owned by members of the "S" and "T" families,<sup>[5]</sup> who are knowledgeable about the activities and investments of "P" and the Company. "S" is "R's" President and, as such, is responsible for all decision-making. "R's" other shareholders function in an oversight capacity.

"R" employs persons who trade commodity interests for the Company (the "Traders"). To obtain Traders, "R" solicits trainees upon graduation from college. It focuses on graduates with no prior trading experience who have demonstrated certain characteristics and accomplishments. "R" provides each Trader with a salary and health insurance, and specifically trains each Trader to trade commodity interests for the Company using the technique that "S" designed.<sup>[6]</sup> A Trader may have no client except for the Company. Traders are directly supervised by "Q".<sup>[7]</sup>

A separate limited liability company ("TLLC") will be established for each Trader who has passed a certain training threshold. This is intended to insulate the Company and each of the other TLLCs from an individual Trader's liability. Functionally, the TLLCs would be identical and would be under common control of the Company, which would invest substantially all of its assets through the TLLCs.

Based upon the foregoing, you request confirmation that the exemption from CPO registration in Rule 4.13(a)(1)<sup>[8]</sup> is available to any person who acts as a general partner of "P" or a managing member of the Company. Rule 4.13(a)(1) provides that a person is exempt from registration as a CPO if -

(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 presentation). (Emphasis added.)

While it appears that the General Partner of "P" and "S" as a co-managing member of the Company meet the criteria of Rule 4.13(a)(1), it further appears that "Q" does not. This is because "Q", as the other co-managing member of the Company, receives compensation from "R" for overseeing the activities of the Traders. The Division believes that this type of compensation arrangement is the sort of indirect arrangement that makes relief under Rule 4.13(a)(1) unavailable. Otherwise, a person who both served as the CPO and the CTA of a pool could easily evade the requirements of the rule by claiming that the compensation it received from the pool was for providing advice to the pool as its CTA, and not for managing the pool as its CPO.

The Division further believes, however, that relief from CPO registration is merited in this case, in light of your representations concerning: (1) the close family relationships between the investors in "P" and the Company; (2) the financial and business backgrounds of these investors; (3) the decade-long operation of "P"; and (4) the close and lengthy relationship "Q" has had with various of the investors and, in particular, "S", whose trading system will be employed by "R" through the Traders, its employees. Accordingly, based upon your representations, the Division will not recommend that the Commission commence any enforcement action against "P" or "Q" as Managing Members of the Company for failure to register as a CPO under Section 4m(1) of the Act.

You also request confirmation that the exemption from CTA registration in Section 4m(1) is available to "R".<sup>[9]</sup> In support of this request, we note your representations that: (1) "R" will not be providing commodity interest trading advice to more than 15 persons<sup>[10]</sup>; and (2) the Company and the TLLCs will be "R's" sole clients. Accordingly, based upon your representations, the Division confirms that the exemption from CTA registration in Section 4m(1) is available to "R".

This letter does not excuse "P" or "Q" from compliance with any otherwise applicable requirements contained in the Act or in the Commission's regulations issued thereunder. For example, each remains subject to all applicable antifraud provisions of the Act and the regulations and to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the regulations. Moreover, this letter is applicable to "P" and "Q" solely in connection with their serving as Managing Members of the Company and it is effective from this date forward.

This letter, and the no-action position and interpretation provided herein, are based upon the representations that have been made to the Division. Any different, changed, or omitted material facts or

circumstances, including the composition of "P" or the Company, might render this letter void. You must notify the Division immediately in the event the operations or activities of "Q" or the Company change in any material way from those represented to us. Further, this letter represents the position and interpretation of the Division only. It does not necessarily reflect the views of the Commission or of any office or other division of the Commission.

If you have any questions concerning this correspondence, please contact Barbara S. Gold, Assistant Chief Counsel, at (202) 418-5450.

Very truly yours,

John C. Lawton  
Acting Director

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<sup>[1]</sup> 7 U.S.C. 6m(1) (2000).

<sup>[2]</sup> There are eight adult family members who are involved in "P", each of whom is an "accredited investor" as defined in Rule 501(a)(5) or (a)(6) of Regulation D under the Securities Act of 1933.

<sup>[3]</sup> Her responsibilities included the following areas: administration, internal accounting and reporting, verifying trades and reconciling brokerage statements, setting up and monitoring investments with outside managers, providing information for tax returns of family members and liaising with accountants and extensive contact and interaction with family members. Additionally, from 1994 until commencing full-time work as "S's" office manager, "Q" held positions with various commodity interest money management firms.

<sup>[4]</sup> 7 U.S.C. 12a(2) or 12a(3) (2000).

<sup>[5]</sup> With the exception of "S's" ex-wife, these individuals include the persons referred to in n. 2, above.

<sup>[6]</sup> "R's" employee training program involves a structured course, individual mentoring, paper trading, and extensive research and charting of recurring patterns.

<sup>[7]</sup> In addition, "Q" is responsible for the setting up and supervision of computer systems for trading, Trader brokerage accounts, the Company's health insurance program and all other aspects of office administration and human resource management.

<sup>[8]</sup> Commission rules cited herein are found at 17 CFR Ch. I (2001).

[\[9\]](#) You also request confirmation that the Section 4m(1) exemption from CTA registration is available to "Q" and the Traders. It appears, however, that these persons are, at most, principals of "R". Accordingly, they do not need relief from CTA registration because they have no obligation to separately register as a CTA.

[\[10\]](#) See CFTC Staff Letter No. 86-10, [1986- 1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,016 (April 24, 1986), at p. , n. 9, wherein the Division stated that various trusts established by immediate members of a family should be counted as one person for the purpose of the exemption from CTA registration in Section 4m(1).