

CFTC Letter No. 97-06**February 14, 1997****Division of Trading & Markets**

Re: Rule 4.7 -- Relief permitting QEP/QEC treatment of an employee investment trust formed to permit officers and employees to invest in pools that it operates

Section 4m(1) -- CPO registration relief for trustees of such employee investment trust

Dear :

This is in response to your letter dated July 22, 1996 to the Division of Trading and Markets (the "Division") of the Commodity Futures Trading Commission (the "Commission"), as supplemented by your letter dated January 24, 1997 and by telephone conversations with Division staff. By your correspondence you request on behalf of "S" a Delaware limited partnership registered as a commodity pool operator ("CPO"), "Y" a United Kingdom limited partnership registered as a commodity trading advisor ("CTA"), "T" a Cayman Islands limited partnership registered as a CPO, and "U", a British Virgin Islands corporation that is in the process of registering as a CTA (collectively "S" and Affiliates") the following: (1) relief permitting "S" to treat as a qualified eligible participant ("QEP") as defined in Commission Rule 4.7(a)¹ a trust (the "S" Trust," not yet established), the participants in which will not all be QEPs, and the assets of which will be used to purchase participations in two pools ("V" a Cayman Islands limited liability company referred to herein as "V" and "X", a Delaware limited partnership referred to herein as "X") for which "S" has claimed exemption from certain CPO disclosure, reporting and recordkeeping requirements pursuant to Rule 4.7(a); (2) relief permitting "T" and "S" to treat "X" and "V" as QEPs notwithstanding that not all of the participants in "S" and "V" are QEPs and that in excess of ten percent (in fact substantially all) of the assets of "X" and of "V" are invested in "W", a Cayman Islands limited partnership for which "T" and "S" have claimed exemption from CPO disclosure, reporting and recordkeeping requirements pursuant to Rule 4.7(a); (3) relief permitting "Y", which has claimed relief from certain CTA disclosure and recordkeeping requirements pursuant to Rule 4.7(b), to treat "W" and "V" as qualified eligible clients ("QECs") as defined in Rule 4.7(b) notwithstanding that (absent relief) two of the participants in "W" ("X" and "V") and one of the participants in "V" (the "S" Trust) would not be QEPs due to the "S" Trust's participation in "X" and "V"; (4) relief permitting "U", following its registration as a CTA, to treat "W" and "V" as QECs for purposes of claiming exemption from certain CTA disclosure and recordkeeping requirements pursuant to Rule 4.7(b); and (5) relief for the trustees of the "S" Trust from the requirements to register under the Commodity Exchange Act (the "Act")² as a CPO and/or as a CTA.

Based upon the representations made in your correspondence, we understand the relevant facts to be as follows. "S" and Affiliates, through a complex system of intermediary entities, are ultimately owned by fifteen individuals, each of whom is or will be listed as a principal of "S" and all but two of whom are registered as associated persons ("APs") of "S".³ "S" acts as CPO and CTA for eight commodity pools with respect to which it claims exemption under Rule 4.7 (the "S" Pools).⁴ Substantially all of the assets of the "S" Pools are invested in a single investee pool, "W". "T" is the general partner of "W", and the general partner of "T" is wholly-owned by "S".

"W" receives commodity interest trading advice from "S" and "Y".⁵ It is intended that once "U" is registered as a CTA, it will also provide commodity interest trading advice to "W".⁶

The "S" Employee Investment Plan

"S" proposes to implement an employee investment plan (the "S" Plan") which will provide for voluntary, after-tax contributions to the "S" Trust by present and future officers and employees of "S" and Affiliates, and by the immediate family members (including spouses and minor children or investment vehicles established for the benefit of such spouses and minor children) of such officers and employees in instances where the officer or employee is an accredited investor as defined in Regulation D⁷ of the Securities Act of 1933 (collectively "S" Investors").⁸ Substantially all of the "S" Trust's assets will, in turn, be invested in two of the "S" Pools. For tax purposes, "S" has determined that funds contributed to the "S" Trust by United States taxpayers will be invested in "X", and funds contributed by foreign taxpayers or by individual retirement accounts of employees of "S" and Affiliates will be invested in "V". As noted above, substantially all of the assets of the "S" Pools, including "X" and "V", are invested in "W".

Eligibility

You state that, subject to certain contribution limitations, participation in the "S" Plan (and thereby participation in the Trust) will be open to all "S" Investors. A non-QEP participant in the "S" Plan must have a combined annual income with his or her spouse of \$200,000, and will be permitted to invest subject to a minimum amount of \$20,000 up to an annual limit of \$2,500,000, provided that the amount invested does not exceed ten percent of such combined annual income of the non-QEP participant and his or her spouse for such year. Participants who are QEPs will not be subject to these investment restrictions. Participation will not be restricted to accredited investors or to QEPs, except that only an officer or employee that is an accredited investor may invest on behalf of such person's spouse or minor child. Each participant will be permitted to withdraw amounts from his or her participation in the "S" Trust at the end of any calendar year, upon forty-five days' prior written notice.

Administration

The administrators of the "S" Plan will be "CC", "HH" and "MM", each of whom, as noted above, is registered as an associated person, and is listed as a principal, of "S". You represent that all of these individuals are sophisticated and knowledgeable in investment matters, that they are QEPs, and that they are intimately involved in the investment management affairs of "X" and "V" and/or "W".

The "S" Trust

"S" intends to establish the "S" Trust pursuant to the "S" Plan. The trustees of the "S" Trust will be the same individuals who will serve as administrators of the "S" Plan. The "S" Trust will not be a qualified plan under Section 401(a) of the Internal Revenue Code of 1986, as amended, because distributions will not be tied to deferral of compensation until a participant's retirement. The "S" Trust will not be subject to the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). The trustees will have responsibility for overall management and administration of the "S" Trust, including the investment of trust assets, employment of agents to provide accounting, custodial and other services to the "S" Trust, and execution of documents on behalf of the "S" Trust. Because the governing document of the "S" Trust will require investment of trust assets in "X" and "V" in the manner described above, the trustees will have no discretion with respect to such investments or any other aspect of the management of trust assets, other than the investment of available cash in short-term instruments.

Fees

"S" currently does not charge management or incentive fees to "S"-related investors in its investment vehicles. However, "S" may in the future charge a portion of the management and incentive fees it would be entitled to receive from "X" and "V" that are attributable to investments in such entities by the "S" Trust. The fees charged will be no greater than those charged to unaffiliated investors, and will only be imposed prospectively on new investments (or reinvestments) made by participants in the "S" Trust. In addition, such participants will receive advance notice of the possibility of such charges being imposed and actual notice when such charges are in fact imposed.

Access to books and records

You represent that each of the officers and employees seeking to participate in the "S" Trust will devote a significant portion of their work efforts to activities involving "W", "X" and/or "V", making them knowledgeable about such organizations' operation and structure. You further state that all "S" Investors who are not members of the "management group" of "S" will be knowledgeable about the affairs of "S", "X", "V" and "W", and will have full access to senior management of "W" in that regard, as well as broad access to books and records containing performance data, financial statements, capital structure and offering documents (such as the private placement memorandum for the relevant investment vehicle). "S" Investors will also

receive the same financial information and offering documents provided to non-"S" investors. They will not, however, be permitted access to proprietary valuation models, highly detailed position reports or other similar highly confidential information (which materials are not available to other investors in "X", "V" or "W"). "S" believes that the dissemination of such proprietary materials could significantly disadvantage "W" competitively (and could thereby adversely affect its investors).

Undertakings

In support of your request, you represent that "S" undertakes to do the following:

1. Obtain from each participant in the "S" Trust written confirmation of such participant's understanding that the "S" Trust is operated pursuant to relief granted by the Division, including relief from the "ten percent restriction" of Rule 4.7(a)(1)(ii)(B)(2)(xi), and that therefore, the "S" Trust is not required to make, and is not providing to participants, all of the disclosures and financial reports otherwise required of a registered CPO under Commission rules;
2. Obtain from each participant in the "S" Trust written confirmation of such participant's understanding of the risks of trading futures contracts;
3. Obtain from each "S" Trust participant who is not a QEP prior written consent to be treated as a QEP; and
4. Provide the Commission with written acknowledgments by each of "S" and the Trustees of the "S" Trust that they will be jointly and severally liable for any violation of the Act or of Commission rules applicable to CPOs and CTAs committed by "S" or by any of the Trustees in connection with the operation of the "S" Trust.

Based on the foregoing, we believe that the "S" Trust is a pool within the meaning and intent of Rule 4.10(d). Nevertheless, we believe that under the specific circumstances you describe, it would not be contrary to the public interest to grant CPO registration relief to the trustees of the "S" Trust. Accordingly, the Division will not recommend that the Commission take any enforcement action against "CC", "HH" or "MM" for failure to register as a CPO under Section 4m(1) of the Act in connection with serving as the trustees of the "S" Trust.⁹ This position is, however, subject to the condition that "S" provides the Division with written notice of the name of the "S" Trust when that name is selected.

Furthermore, the Division believes that your request that the "S" Trust be treated as a QEP for purposes of (1) "S's" and "T's" respective Rule 4.7(a) exemption claims with respect to the operation of "X", "V" and "W"; and (2) "Y's" existing claim and "U's" prospective claim of

exemption under Rule 4.7(b) with respect to providing commodity interest trading advice to "W" has merit. Accordingly, the Division will not recommend that the Commission take any enforcement action against "S", "T", "Y" or "U" for failure to comply with the QEP criteria (or QEC criteria, as applicable) of Rule 4.7 with respect to the "S" Trust if they permit the "S" Trust to invest in "X" and "V" (and, through "X" and "V", in "W").

This letter is applicable to: (1) "CC", "HH", "MM" and "JJ" solely in connection with their roles as trustees of the "S" Trust; and (2) "S", "T", "Y" and "U" solely in connection with the operation of, and provision of commodity interest trading advice to, "X", "V" and "W". Furthermore, this letter does not excuse any of the foregoing from compliance with any other applicable requirements contained in the Act or in the Commission's regulations issued thereunder. For example, each remains subject to the antifraud provisions of Sections 4b and 4o of the Act¹⁰ to the reporting requirement for traders set forth in Parts 15, 18 and 19 of the Commission's regulations, and to Rules 4.20 and 4.41 in connection with his operation of the Partnership.

This letter is based upon the representations provided to us and is subject to compliance with the condition set forth 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 or activities of "CC", "HH" and "MM", the "S" Trust, "S", "U", "Y", "T", "X", "V", or "W" change in any way from those represented in your letter, as supplemented.

Further, this letter represents the position of the Division of Trading and Markets only. It does not necessarily reflect the views of the Commission or of any other division or office of the Commission. If you have any questions concerning this correspondence, please contact me or Christopher W. Cummings, an attorney on my staff, at (202) 418-5445.

Very truly yours,

Susan C. Ervin

Chief Counsel

¹ Commission rules referred to herein are found at 17 C.F.R. Ch. I (1996).

² 7 U.S.C. § 1 et seq. (1994).

³ The referenced individuals are "AA", "BB", "CC", "DD", "EE", "FF", "GG", "HH", "II", "JJ", "KK", "LL", "MM", "NN" and "OO". "II's" registration as an AP of "S" was withdrawn in 1994 and "OO" is not registered as an AP. "S" is preparing appropriate amendments to its Form 7-R to reflect the recent addition of three of these individuals as principals.

⁴ In connection with providing commodity interest trading advice to the "S" Pools (for which it acts as CPO), "S" relies upon the exemption from CTA registration afforded by Rule 4.14(a)(4).

⁵ Because "S" owns the general partner of "T" (which is the CPO of "W"), "S" also relies upon the exemption from CTA registration afforded by Rule 4.14(a)(4) in connection with providing trading advice to "W". "Y" has filed a notice of claim of exemption under Rule 4.7(b).

⁶ A notice of claim of exemption pursuant to Rule 4.7(b) will be filed by "U".

⁷ 17 C.F.R. § 230.501 et seq. (1996).

⁸ 15 U.S.C. §77a et seq. (1994).

⁹ 7 U.S.C. § 6m(1) (1994).

¹⁰ 7 U.S.C. §§ 6b and 6o (1994).