CFTC Letter No. 04-17
May 25, 2004
Exemption
Division of Clearing and Intermediary Oversight

Re: "X" -- Request for Relief From Natural Person Criteria of Rule 4.13(a)(4)

Dear:

This is in response to your letter dated January 15, 2004, to the Division of Clearing and Intermediary Oversight (the "Division") of the Commodity Futures Trading Commission (the "Commission"), as supplemented by your email messages dated February 10, 2004, March 22, 2004, March 25, 2004, and March 29, 2004, and telephone conversations with Division staff (the "correspondence"). By the correspondence, you request, on behalf of "X", the general partner and commodity pool operator ("CPO") of the "Fund", that the Division permit "X" to treat the mother-in-law of one of its principals as a qualified eligible person ("QEP") for the purpose of continuing to operate under the CPO registration exemption of Rule 4.13(a)(4).

Based upon the representations contained in your correspondence, we understand the facts to be as follows: "X" is operating the Fund pursuant to the CPO registration exemption of Rule 4.13(a)(4) and has filed a notice of exemption in accordance with the requirements of that rule. "A", the mother-in-law of a principal of "X", seeks to invest in the Fund. Counsel requests, on behalf of "X", that the Division permit "A" to be treated as a QEP, thus allowing "X" to continue operating under the registration exemption of Rule 4.13(a)(4).

The registration exemption of Rule 4.13(a)(4) is available to CPOs operating pools comprised of certain highly sophisticated participants, including natural-person QEPs, as defined in Rule 4.7(a)(2). Of particular relevance here are Rules 4.7(a)(2)(vi) and 4.7(a)(2)(viii)(A)(5). The former rule defines a QEP to include a "qualified purchaser," *i.e.*, any natural person who owns not less than \$5,000,000 in investments. Although "A" has a net worth of more than \$2 million, and the value of her investment portfolio exceeds \$2 million, she does not meet the "qualified purchaser" criterion. The latter rule defines a QEP to include the "spouse, child, sibling or parent" of a principal of a CPO. The rule does not, however, include a principal's parent-in-law as a QEP.

Because "A" has a net worth of \$2 million, she is an accredited investor, as that term is defined in Rule 501(a)(5) under the Securities Act of 1933. Last year, when the Commission considered various revisions proposed by the National Futures Association and the Managed Funds Association ("MFA") to the CPO registration exemptions, the Commission expressly declined to allow CPOs to treat natural-

person accredited investors as QEPs for purposes of Rule 4.13(a)(4). Instead, the Commission made available the CPO registration exemption of Rule 4.13(a)(3) for CPOs that operate pools containing natural-person accredited investors, provided that the pool trades futures and options on futures within certain specified limits. Consequently, Division staff suggested that "X" consider operating its pool pursuant to the registration exemption of Rule 4.13(a)(3). You have stated, however, that "X" is unable to operate the Fund within the trading parameters of that rule.

In light of the foregoing, the Division does not believe that it is appropriate to grant the requested relief, and your request for relief is hereby denied. If you have any questions concerning this correspondence, please contact R. Stephen Painter Jr., an attorney on my staff, at (202) 418-5416.

Very truly yours,

James L. Carley Director

- [1] Commission rules referred to herein are found at 17 C.F.R. Ch. I (2003).
- Commenting on the rule proposal, which ultimately was adopted as Rule 4.13(a)(4), the Commission noted that "[w]hile the MFA Proposal would include *any* natural person who is a QEP under Rule 4.7, the Commission does not believe that proposed Rule 4.13(a)(4) needs to be so broad[.]" 68 Fed. Reg. 12622, 12627 (March 17, 2003) (proposing release). The Commission further noted that natural persons who come within the MFA Proposal but not within Rule 4.13(a)(4) "include persons who are 'accredited investors' *and* who meet the Portfolio Requirement of Rule 4.7(a)(1)(v)[.]" *Id.* at 12627 n.41.
- Division staff further advised you that its predecessor Division, the Division of Trading and Markets, had in certain circumstances permitted a CPO to treat a principal's in-laws as QEPs for purposes of Rule 4.7. Specifically, in CFTC Staff Letter No. 94-36 [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,046 (March 17, 1994), the Division permitted a CPO to treat the in-laws of the sole shareholder of the general partner of the CPO as QEPs, provided that, with respect to the in-laws' investment, the CPO waived any fees, waived the minimum investment requirement, waived or relaxed restrictions on the in-laws' ability to redeem, and provided the in-laws' reports required by Rule 4.22.

Although Rule 4.13(a)(4) provides for broader relief than Rule 4.7, the Division nevertheless asked you whether "X" would, as a predicate of relief under Rule 4.13(a)(4), be willing to treat "A" like the CPO in Letter 94-36 treated the relatives at issue therein. You responded in the negative to this query.