



U.S. COMMODITY FUTURES TRADING COMMISSION

95-106

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DIVISION OF
TRADING & MARKETS

November 9, 1995

Re: Rule 4.7 -- Request for Relief To Treat Certain Foreign
Persons as Qualified Eligible Clients

Dear :

This is in response to your letter dated September 5, 1995 to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), in which you request on behalf of "X" that the Division confirm that "X" may treat certain categories of foreign clients, as qualified eligible clients ("QECs") under Rule 4.7(b).^{1/} As is explained below, you believe that these foreign entities ("the Foreign Clients"), but for their foreign organization, are comparable in nature and purpose to domestic entities that qualify for QEC status.^{2/}

^{1/} Unless otherwise noted, Commission rules referred to herein are found at 17 C.F.R. Ch. I (1995) (as amended by 60 Fed. Reg. 38,146 at 38,182 (July 25, 1995)).

^{2/} For the purposes of this letter the term "foreign entity" is defined as:

- (1) A partnership, corporation or other entity, other than an entity organized principally for passive investment, organized under the laws of a foreign jurisdiction and which has its principal places of business in a foreign jurisdiction;
- (2) An estate or trust the income of which is not subject to United States income tax regardless of source;
- (3) An entity organized principally for passive investment such as a pool, investment company or other similar entity, provided that units of participation in the entity held by United States persons represent in the aggregate less than 10 percent of the beneficial interest in the entity and that such entity was not formed principally for the purpose of facilitating investment by

(continued...)

Based upon the representations made in your letter, as supplemented by telephone conversations with Division staff, we understand the pertinent facts to be as follows. "X" is a "global investment manager." It is registered as an investment adviser under the Investment Advisers Act of 1940^{3/} and a commodity trading advisor ("CTA") under the Commodity Exchange Act ("Act").^{4/} "X" is currently providing commodity trading advice to QECs and, in this regard, filed a notice of exemption pursuant to Rule 4.7(b) with the Commission and the National Futures Association on April 3, 1995.

"X" acts as a CTA exclusively to "corporate and institutional" entities. "X's" clients include collective investment vehicles, employee benefit plans, commercial entities, insurance companies, banks, sovereign governments and other sovereign entities, international organizations and charitable institutions such as endowments and foundations. These clients are located both within and outside of the United States. Subject to local law and market conditions, "X" generally does not distinguish between its domestic and foreign clients with respect to trading strategies and advisory services offered. The Foreign Clients with respect to which you seek relief are corporate and institutional entities which have portfolios with a minimum value of \$25,000,000, although not all such assets necessarily will be placed with "X" for management.

In support of your request, you claim that while Rule 4.7 defines the permissible categories of QECs in terms of United

^{2/} (...continued)

United States persons in a pool with respect to which the operator is exempt from certain requirements of Part 4 of the Commission's regulations by virtue of its participants being non-United persons;

- (4) A pension plan for the employees, officers or principals of an entity organized and with its principal place of business outside the United States.

For the purposes of the above definition, the terms "United States" and "United States persons" have the same meaning as in Rule 4.7(a) (1) (ii) (C).

^{3/} 15 U.S.C. § 80b-1 et seq. (1994).

^{4/} 7 U.S.C. § 1 et seq. (1994).

States laws and forms of organization,^{5/} the form and organization of the Foreign Clients will vary from jurisdiction to jurisdiction. Thus, while the Foreign Clients will have been organized pursuant to the laws of their home jurisdictions, their structure may not coincide with the United States regulatory categories set forth in Rule 4.7(b). For example, foreign collective investment vehicles may be organized in the form of, *inter alia*, an open-ended investment company, a mutual investment fund (e.g., "Fonds Communs de Placement" -- an arrangement for the joint ownership of assets which is not a separate legal entity) or special funds ("Spezialfonds" -- with one or more members), depending upon the jurisdiction of organization. Thus, Foreign Clients may not be required to organize or register under United States federal or state laws or be subject to the regulatory oversight of state or federal authorities as specified in Rule 4.7(b), although such Clients will be operating in full compliance with the laws of their home jurisdiction.

You stress that "X" is not requesting that all of its Foreign Clients be deemed eligible for treatment as QECs without regard to the qualifying criteria specified in Rule 4.7(b). Rather, "X" is requesting confirmation that it may treat as QECs foreign entities that are comparable in nature and purpose to entities expressly covered in the QEC definition but for their foreign organization and whose investment resources are substantially in excess of the otherwise applicable QEC benchmarks. You claim that this proposal is consistent with the underlying rationale of Rule 4.7 in that such entities "possess the investment sophistication and financial resources" that the Commission has determined to be necessary to assess the risks and benefits of a CTA's trading programs. You stress that each foreign client to which the requested relief would be extended will have a minimum portfolio of greater than ten times the minimum portfolio required of QECs by Rule 4.7(b). You also note that not allowing "X" to claim the same relief available under Rule 4.7(b) for Foreign Clients as for United States clients produces an anomalous result in that Foreign Clients no matter how financially sophisticated or highly capitalized are ineligible for QEC treatment.

Based upon the foregoing, it appears that granting the requested relief would not be contrary to the public interest and the

^{5/} For example, Rule 4.7(b) grants QEC status to investment companies registered under the Investment Company Act of 1940, banks and insurance companies organized under United States federal or state laws, employee benefit plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA") and tax exempt organizations as defined pursuant to Section 501(c)(3) of the Internal Revenue Code.

purposes of Rule 4.7(b). Accordingly, subject to the conditions stated below, the Division will not recommend that the Commission take enforcement action against "X" if it treats as QECs Foreign Clients which: (1) are comparable in nature and purpose to those United States entities eligible for QEC treatment pursuant to Rule 4.7(b); and (2) have portfolios with a minimum value of \$25,000,000.^{6/}

This relief is subject to the condition that each Foreign Client as to whom "X" will claim relief under the terms of this letter consents in writing to being treated as a QEC. Further, "X" may not claim relief under the terms of this letter for any foreign entity that is registered or required to be registered with the Commission under the Commodity Exchange Act ("Act")^{7/} and is not otherwise exempt from such registration. Finally, "X" must keep all records relating to the qualifications of such Foreign Clients in support of the relief granted herein in accordance with Rule 1.31.

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 if the nature of the Foreign Clients changes in any way from that represented to us.

We note that this letter relieves "X" solely from certain requirements of Rule 4.7(b) and does not excuse it from compliance with any other applicable requirements contained in the Act or in the Commission's regulations issued thereunder. For example, "X" remains subject to the antifraud provisions of Section 40 of the Act,^{8/} to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's regulations,^{9/} and to all other applicable requirements of Part 4. This letter represents the views of the Division only and does not necessarily represent the views of the Commission or any other office or division of the Commission. If you have any questions concerning

^{6/} However, all such assets do not have to be placed with "X" for management. Further, we note that any Foreign Client for which "X" may claim relief by the terms of this letter would be considered a "person listed" in Rule 4.7(b)(1)(ii)(A) or (B) for the purposes of claiming relief under Rule 4.7(b)(1)(ii)(D).

^{7/} 7 U.S.C. § 1 et seq. (1994).

^{8/} 7 U.S.C. § 60 (1994).

^{9/} 17 C.F.R. Parts 15, 18, 19 (1995).

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this correspondence, please contact me or Thomas E. Joseph, an attorney on my staff, at (202)418-5450.

Very truly yours,

Susan C. Ervin
Chief Counsel