U.S. COMMODITY FUTURES TRADING COMMISSION
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96-66

DIVISION OF
TRADING & MARKETS

June 14, 1996

Re: Request for Relief from CPO Registration Requirement of Section 4m(1) of the Act
Request for Relief from the QEP Criteria of Rule 4.7(a)

Dear :

This is in response to your letter dated February 16, 1996, to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by your letter dated March 20, 1996, and by telephone conversations among you, "A", your associate, and Division staff, in which you request that the Division not recommend that the Commission take any enforcement action against: (1) "X" for failure to comply with the commodity pool operator ("CPO") registration requirements of Section 4m(1) of the Commodity Exchange Act ("Act")[1/] in connection with its serving as the general partner of ("Fund I"), ("Fund II") and certain other United States-domiciled funds as may in the future be formed (collectively, "U.S. Funds"); and (2) "Y" for failure to comply with the "qualified eligible participant" ("QEP") criteria of Rule 4.7(a) in connection with serving as the CPO of a U.S. Fund or non-United States domiciled fund ("Non-U.S. Fund") (collectively, "Funds").[2/]

Based upon the representations made in your correspondence, we understand the relevant facts to be as follows. "X" is the sole general partner of Fund I and Fund II, each of which is a Delaware limited partnership. "X" does not engage in any activity other than the activities discussed herein, including any other activity that would subject it to registration as a CPO or CTA. "Y" will serve as the CTA of these Funds. "B", "C" and "D" ("Directors"), each a United States resident, will serve as members of the boards of directors of ("Fund III") and certain

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1/ 7 U.S.C. §6m(1) (1994).

2/ Commission rules referred to herein are found at 17 C.F.R. Ch. I (1995), as amended by 60 Fed. Reg. 38146 (July 25, 1995).

other non-U.S. Funds as may in the future be formed.[3/] The Directors comprise a minority of the members of the board of directors of Fund III, a Cayman Islands company.[4/] "Y" similarly will provide commodity interest trading advice to Fund III. "Y" is registered with the Commission as a CPO. Each Director is listed as a principal of "Y" and, in addition, "D" is registered as an associated person ("AP") of the firm. The Funds will be operated as "exempt pools" under Rule 4.7(a), and "Y" will file a Rule 4.7(a) notice of claim for exemption with respect to each Fund. The Funds invest in a variety of asset classes, including securities, real estate, derivatives and any other investments determined to be appropriate.

Inasmuch as "X" will be serving as the general partner of Fund I and Fund II, and as the general partner of each subsequently organized U.S. Fund, it would, absent relief, be required to be registered as a CPO in connection with its operation of each such U.S. Fund.[5/] You propose that "Y", with respect to Funds I and II and any subsequently organized U.S. Fund, be permitted to serve as the Funds' CPO.[6/] In support of this request, you represent that: (1) "Y" is registered as a CPO; (2)

3/ Fund III and any other Non-U.S. Fund will have as participants only persons who are not "United States persons," as that term is defined in Rule 4.7(a), and the "Non-QEPs" and "Other Non-QEPs" discussed below.

4/ The majority of the members of the board of directors of Fund III are, and with respect to any other Non-U.S. Fund will be, Non-United States citizens and residents who are unaffiliated with "X", "Y" or any of their affiliates.

5/ See CFTC Staff Interpretative Letter No. 75-16, [1975-77 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,104 (October 15, 1975).

6/ With respect to a U.S. Fund, "X" will receive compensation based on profits and "Y" will receive a fee based on assets under management. You explain that this structure, although implemented pursuant to arms' length business arrangements, has potential tax advantages as well. In this regard, you explain that the nature of the incentive compensation to be charged the Fund is such that if these fees were received by a person other than a partner (i.e., by "Y" in lieu of "X"), the fees would be taxed to such person at the higher ordinary income rates in lieu of the lower capital gains rate.

"Y" and "X" are and will be wholly owned by the Directors[7/]; and (3) "D" will remain registered as an AP and, along with "B" and "C", will remain listed as a principal of "Y". In addition, we note your representation that "X" will not engage in any other activity that could subject it to regulation as a CPO or CTA.

Based upon the foregoing, the Division will not recommend that the Commission take any enforcement action for failure to register as a CPO pursuant to Section 4m(1) of the Act against "X" in connection with its serving as the general partner of a U.S. Fund.[8/] This position is, however, subject to the following conditions: (1) "Y" will serve as the CPO of each U.S. Fund; (2) "X" will not exercise discretion, supervision or control over or participate in: (i) the solicitation, acceptance or receipt of funds or property to be used for purchasing interests in a Fund[9/] or (ii) the investment, use or other disposition of funds or property of a Fund; (3) within thirty days from the date of this letter and before any assets of a Fund are allocated to transactions in commodity interests, "X" and "Y" provide the

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7/ You have explained that the Directors are authorized to, and from time to time do, allocate their profits from "X" to other persons employed by "X" or an affiliated company. For the purpose of our letter, such allocation does not affect the ownership of the firm by the Directors.

8/ Inasmuch as: (1) the Directors are, at a minimum, listed as principals of "Y"; and (2) the only United States persons who may participate in a Fund are principals of "Y" or its affiliate, "Z", it appears that "Y" may appropriately serve as the CPO of the Non-U.S. Funds without the Directors having to request a CPO registration relief no-action position with respect to their activities. See CFTC Staff Interpretative Letter No. 92-3, [1992-94 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,221 (Feb. 3, 1992).

9/ Thus, in the event "D" seeks to engage in such activity, it must be as an AP of "Y". Further in this regard, you have explained that in furtherance of compliance with Federal and state law (e.g., Delaware law), the general partners of a limited partnership (i.e., "X" with respect to Funds I and II) must exercise discretion, supervision and control over, and must participate in, the admission of new limited partners, such that it must confirm their qualifications as accredited investors and may for any reason whatsoever refuse to accept any person as a limited partner. "X" can, and will, comply with all of the other criteria of condition (2). Accordingly, "X's" compliance with the foregoing state law provisions will not be deemed to be in conflict with compliance with condition (2).

Division with a signed and dated acknowledgement whereby each accepts joint and several liability for any violations of the Act[10/] or the Commission's regulations promulgated thereunder applicable to CPOs in connection with "X" and "Y" serving as general partner and CPO, respectively, of Fund I and Fund II; (4) "Y" provides the Division with written notice of the name, when selected, of each subsequently organized U.S. Fund for which it intends to claim the relief available hereunder; and (5) before any assets of any such subsequently organized U.S. Fund are allocated to transactions in commodity interests, "X" and "Y" provide the Division with the written acknowledgment in the nature of that specified in item (3) above with respect to each such subsequently organized U.S. Fund.

As noted above, "Y" also seeks relief from the QEP criteria of Rule 4.7(a) with respect to the investment in a Fund by certain persons who are not QEPs (the "Non-QEPs"). The Non-QEPs for whom relief is sought are as follows:

1. "L", a Senior Vice President and the General Counsel of "Y", who materially participates in all of "X'" and "Y's" legal matters as well as those of the Funds. He has extensive involvement in corporate acquisitions and dispositions and asset sales for "X", "Y" and the Funds. He has worked for "X" and its affiliates since November 1994, has had a professional relationship with two of the three principals of "Y" since February 1992, and has a current investment relationship with three of "X's" affiliates.

2. "M", a Senior Vice President and the Chief Operating Officer of "Y", who is primarily responsible for the administration and operation of "Y", including approximately thirty investment funds, as well as approximately 200 private investment vehicles. He has worked for "X" and its affiliates since November 1994, and has a current investment relationship with two "X's" affiliates.

3. "N", a Senior Vice President and the Director of Real Estate of "Y", who is responsible for all of the real estate activities for "Y", which has a portfolio of $250 million. He has worked for "X" and its affiliates since January 1995, has had a personal and professional relationship with one of the three principals of "Y" for over fifteen years, and has had a professional

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10/ 7 U.S.C. §1 *et seq*. (1994).

relationship with another principal of "Y" for the last two years.

You further request confirmation that five other non-QEPs ("Other Non-QEPs") may also invest in a Fund. By letter dated May 5, 1995, the Division issued no-action relief from compliance with the QEP criteria of Rule 4.7 to "Z", an affiliate of "Y" and "X",[11] in connection with its serving as the CPO of "V", such that the Other Non-QEPs may invest therein.[12] In support of the instant request that the Other Non-QEPs may invest in a Fund, you represent that there have been no material changes with respect to the representations concerning the Other Non-QEPs made in your correspondence with the Division and as stated in our May 5, 1995 letter, which are hereby incorporated by reference.

Based upon the foregoing, the Division will not recommend that the Commission take any enforcement action against "Y" for failure to comply with the QEP criteria of Rule 4.7 if it admits a Non-QEP or Other Non-QEP into a Fund. This position is, however, subject to the conditions that each Non-QEP and Other Non-QEP: (1) consents in writing to being treated as a QEP for the purpose of investing in a Fund; and (2) has immediate access to the trading and other records of the Fund in which he seeks to invest.

This letter is based on the representations made in your correspondence and is subject to compliance with the conditions set forth above. Any different, changed or omitted facts or circumstances might require us to reach a different conclusion. In this regard, we ask that you notify the Division immediately in the event the operations or activities of "X", "Y", a Director or a Fund change in any way from those as represented to the Division.

We note that this letter is solely applicable in connection with the operation and advisement of a Fund. It does not excuse "Y" or "X" 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 Section 4o of the Act,[13] to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the

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11/ The Directors, along with "E" and "F", are the sole shareholders of "Z".

12/ The Other Non-QEPs, as stated in our May 5, 1995 letter, are: "G", "H", "I", "J" and "K".

13/ 7 U.S.C. §6o (1994).

Commission's regulations and to all other applicable provisions of Part 4.

Further, this letter represents the views of this Division only and does not necessarily represent the views of the Commission or of any other office or division of the Commission. If you have any questions concerning this correspondence, please contact me or Barbara Stern Gold, Assistant Chief Counsel, at (202) 418-5450.

Very truly yours,

Susan C. Ervin
Chief Counsel