

CFTC Letter No. 97-41**June 6, 1997****Division of Trading & Markets**

Re: Rule 4.7(a) -- Request for Relief from Qualified Eligible Participant Criteria and Ten Percent Restriction

Dear :

This is in response to your letter dated December 4, 1996, to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission") as supplemented by telephone conversations with Division staff. By your correspondence, you request on behalf of X that the Division permit the commodity pool operator (CPO) of a Rule 4.7(a) exempt pool into which X invests the assets of the ("Account"), an insurance company separate account operated by X , to be relieved from the restriction in Rule 4.7(a)(1)(ii)(B)(2)(xi)¹ which would prevent the Account from investing more than ten percent of its assets in a Rule 4.7(a) exempt pool ("Ten Percent Restriction") because not all investors in the Account are qualified eligible participants (QEPs) as that term is defined in Rule 4.7(a).

Based upon the representations made in your correspondence, we understand the pertinent facts to be as follows. On March 22, 1996, X filed a notice of eligibility for exclusion from the CPO definition pursuant to Rule 4.5(c) on behalf of the Account.² The Account is a QEP. Currently, all investment decisions on behalf of the Account are made by Y , a registered CPO and CTA. Y invests the funds of the Account following a multi-manager, multi-strategy approach that allocates assets among a number of investment managers operating through limited partnerships, corporations and managed accounts (Select Partnerships). Currently, the Account is invested with several Select Partnerships trading primarily in securities and, to a limited extent, commodity interest contracts. The Account has approximately \$67 million in net assets. The minimum investment in the Account is \$1 million. The majority of the policyholders in the Account are QEPs. However, several irrevocable trusts (the Non-QEP Trusts), representing approximately twenty percent of the assets of the Account, do not qualify as QEPs because they do not have assets exceeding \$5 million. The Non-QEP Trusts have been established by individuals who are themselves QEPs, primarily for estate planning purposes.

The circumstances of the Non-QEP Trusts invested in the Account are as follows:

1. Three such Trusts were established by A, a QEP, for the benefit of his

children and one Trust was established by A for the benefit of his unborn grandchildren. With respect to the children's Trusts, A acts as co-trustee with another individual (B), who is also a QEP. Both A and B are investment professionals who have worked in the securities and commodities industries for over fifteen years. Each of the three children's Trusts has assets in excess of \$1.5 million. With respect to the Trust for the benefit of A's unborn grandchildren, B and the wife of A serve as co-trustees. This Trust has assets in excess of \$3 million. A is responsible for making all investment decisions for each of the aforementioned Trusts.

2. One Trust was established by C, a QEP who has been a futures trader for the past 16 years, for the benefit of his children. One of the trustees is a partner in an accounting firm and the other trustee is a retired futures trader. Both trustees are accredited investors, as that term is defined in Regulation D of the Securities Act of 1933. The Trust has assets in excess of \$1 million. C is responsible for making all investment decisions for the Trust.

3. One Trust was established by D, a QEP who has been trading securities and commodities since 1975, for the benefit of his son. The brother of D, an attorney as well as a futures trader, acts as sole trustee. The Trust has assets in excess of \$1 million. D is responsible for making all investment decisions for the Trust.

4. One Trust was established by E, a QEP, for the benefit of his sons. The sole trustee is the brother of E, who is an accredited investor and a partner in a certified public accounting firm. The Trust has assets in excess of \$3 million. E is responsible for making all investment decisions for the Trust.

In support of your request, you represent that the trustee(s) of each Trust will consent in writing to the treatment of the relevant Trust as a QEP.

Based upon the foregoing representations, it appears that granting the requested relief would not be contrary to the public interest or the purposes of Rule 4.7(a). Accordingly, the Division will not recommend that the Commission take any enforcement action against a CPO of a Rule 4.7(a) exempt pool solely on the basis that the Account invests more than ten percent of the fair market value of its assets in the Rule 4.7(a) exempt pool operated by the CPO.³ This relief is subject to the condition that X provides in writing to the Division the names of the grantor(s) of each Trust discussed in the preceding paragraph of this letter within thirty days of your receipt of this letter.

We note that this letter relieves the CPO of a Rule 4.7(a) exempt pool solely from compliance with certain requirements of Rule 4.7(a) in connection with an investment by the Account in a

Rule 4.7(a) exempt pool operated by the CPO regardless of the participation by the Non-QEP Trusts in the Account. It does not excuse X or the CPO from compliance with any other applicable requirements contained in the Commodity Exchange Act (the "Act")⁴ or the Commission's regulations issued thereunder. For example, each CPO of such a Rule 4.7(a) exempt pool remains subject to the antifraud provisions of Section 40 of the Act,⁵ the reporting requirements for traders set forth in Parts 15, 18, and 19 of the Commission's regulations, and all other applicable requirements of Part 4.⁶ Moreover, this letter does not in any way affect X's obligations to comply with the terms and conditions of Rule 4.5(c) or any otherwise applicable provision of the Act or Commission regulations in connection with its operation of the Account.

This letter is based upon the representations you have made to us and is subject to compliance with the condition stated above. Any different, changed, or omitted facts or circumstances might require us to reach a different conclusion. In this regard, we request that you notify us immediately in the event that the operations or activities of X or the Non-QEP Trusts change in any way from those as represented to us. Further, this letter represents the position of the Division of Trading and Markets only. It does not necessarily represent the views of the Commission or any other office or division of the Commission.

If you have any questions concerning this correspondence please do not hesitate to contact me, or Charles O'Brien of my staff, at (202) 418-5450.

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 Your December 4, 1996 letter requested relief on behalf of X and the Account pursuant to Rule 4.7(a) to allow the Account to treat certain non-QEP investors in the Account as QEPs. However, X is operating the Account pursuant to a Rule 4.5 CPO exclusionary notice. As the Division has advised you, because Rule 4.7(a) makes relief available only to registered CPOs, your initial request was inconsistent with the Rule 4.5 notice. You have therefore revised your initial relief request such that it now is being made with respect to any CPO of a Rule 4.7(a) exempt pool.

³ You also seek relief with respect to future policyholders in the Separate Account that are trusts with similar characteristics to those described in your correspondence. The Division declines to grant such relief at this time. The Division may extend the coverage of the relief provided by this letter on a fact-specific, case-by-case basis, and we invite you to contact us for guidance at such time as the facts specific to any such additional Non-QEP Trust become known.

⁴ 7 U.S.C. § 1 *et seq.* (1994).

⁵ 7 U.S.C. § 60 (1994).

⁶ The relief granted by this letter is prospective in nature only. Thus, for example, to the extent the Account previously has exceeded the Ten Percent Restriction of Rule 4.7(a), any relief granted by this letter does not prevent the Commission from taking action against X or other parties should it be determined that the Account was not a QEP as that term is defined in Rule 4.7(a) prior to the date of this letter.