

CFTC Letter No. 97-95**September 17, 1997****Division of Trading & Markets**

Re: Request to Treat Employee Partnership as a QEP under Rule 4.7(a), for Relief from the Ten Percent Limitation of Rule 4.7(a)(1)(ii)(B)(2)(xi), and for Relief from Providing Quarterly Reports;

Request to Treat Employee Partnership as a QEC under Rule 4.7(b) Where Not All Participants are QEPs

Dear :

This is in response to your letter dated August 12, 1997, 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 Y , a registered commodity pool operator (CPO), that the Division not recommend that the Commission take any enforcement action against (1) Y if it claims relief from Rule 4.7(a) with respect to the operation of the "Fund" notwithstanding participation in the Fund of certain persons which are not "qualified eligible participants" ("QEPs") as defined in Rule 4.7(a); (2) Y if it does not comply with the restriction in Rule 4.7(a)(1)(ii)(B)(2)(xi)(the "Ten Percent Limitation") on the amount of Fund assets that may be invested in pools for which the CPOs thereof have claimed relief pursuant to Rule 4.7(a)¹ (the "Rule 4.7(a) Exempt Pools"); and (3) the CPOs of the Rule 4.7(a) Exempt Pools in which the Fund becomes a participant (the "Investee Pools") if the CPOs thereof do not comply with the Ten Percent Limitation with respect to the Fund's participation in their pools; and (4) Y if it does not comply with the requirement in Rule 4.7(a)(2)(ii) to provide quarterly reports to Fund participants. You also request that Y or an affiliated, registered CPO be able to claim all of the aforementioned relief in connection with future funds for which it or the affiliated, registered CPO will serve as the CPO and for which the same category of investors, as further described herein, would be eligible to participate.

In addition, you request on behalf of Z², a registered commodity trading advisor ("CTA"), or other CTAs retained to trade Fund assets, that the Division not recommend that the Commission take any enforcement action against Z or the other CTAs if they treat the Fund as a "qualified eligible client" ("QEC") as defined in Rule 4.7(b). The Fund, Y and Z are affiliated with V³.

Based upon the representations made in your correspondence, we understand the pertinent facts to be as follows. The Fund will be operated as an employees' investment pool and will be either organized

as a limited partnership or limited liability company. The purpose of the Fund is to reward and retain key personnel of U and to attract talented professionals to the firm. The Fund, when formed, will have total assets in excess of \$5,000,000 and will not be formed for the specific purpose of investing in Rule 4.7(a) Exempt Pools. The Fund will generally be operated as a "fund of funds" and will invest primarily in other commodity pools and/or hedge funds. Certain of the pools in which the Fund may invest are expected to be Rule 4.7(a) Exempt Pools, which may be operated by V affiliates or by non-affiliates.

The Fund will not charge its participants any fees, although fees charged to the Fund by the operators of the Investee Pools and other funds in which the Fund may invest will be paid by the Fund and, accordingly, borne by Fund participants on a pro rata basis. A small percentage of the Fund's assets may be allocated to the direct trading of futures contracts or options on such contracts, which will be managed by Z or another CTA retained by the Fund. The Fund will consist of capital from two sources: U proprietary capital and the voluntary contributions of certain managing directors and limited partners of U who will be participants in the Fund, the "LP/MDs." Each LP/MD is an "accredited investor" as that term is defined in Regulation D under the Securities Act of 1933, although all LP/MDs are not necessarily QEPs.

. . . .

The LP/MDs, which are the Other Individual Limited Partners and the Managing Directors, comprise the persons who are eligible to participate in the Fund. The LP/MDs are highly sophisticated professionals. For fiscal year 1996, the Managing Directors who are not Participating Limited Partners earned over A in compensation, including salary and bonus, with an average annual compensation in excess of B . The LP/MDs who are Participating Limited Partners or Other Individual Limited Partners share in the profits or losses of the U business or receive a fixed return on their capital invested in V .

Participation in the Fund will not be offered to any other persons, including members of the general public. Each LP/MD who invests in the Fund will receive a detailed offering memorandum which will describe, among other things, the types of investments that can be made by the Fund, including investments in other trading vehicles, and the risks associated therewith. Each participant will also receive an annual report regarding the operations and assets of the Fund and that contains financial statements audited by certified public accountants.

You further represent that Y will undertake to: (1) obtain from each LP/MD investor in the Pool written confirmation of such investor's understanding that the Fund will be operated pursuant to relief granted by the Division, including relief from the Ten Percent Limitation; (2) obtain from each LP/MD investor in the Fund written confirmation of such investor's understanding of the risks inherent in investing in the Fund; and (3) obtain from each LP/MD investor who is not a QEP prior written consent to be treated as a QEP.

Absent the requested relief, Y will not be able to treat the Fund as a QEP because although the Fund has assets in excess of \$5 million, it wishes to invest more than ten percent of its assets in Investee Pools, and not all participants in the Fund will be QEPs. Rule 4.7(a)(1)(ii)(B)(2)(xi) provides that unless all of the participants in a collective trading vehicle, such as the Fund, are themselves QEPs, the collective trading vehicle cannot commit more than ten percent of the fair market value of its assets to purchase interests in Rule 4.7(a) Exempt Pools. Further, absent the requested relief, the CPO of any Rule 4.7(a) Exempt Pool could not accept more than ten percent of the Fund's assets as an investment in its pool.

Absent the requested relief, Z or other CTAs retained by the Fund would not be able to treat the Fund as a QEC because not all its participants are QEPs. In support of your request, you represent that the LP/MDs are sophisticated investors, will have ready access to information regarding the Pool's operation and investments, and will be provided with a detailed offering memorandum.

Based upon your representations, it appears that granting the requested relief would not be contrary to the public interest or the purpose of Rule 4.7(a). Accordingly, the Division will not recommend that the Commission take any enforcement action under Rule 4.7(a) against: (1) Y solely on the basis that it operates the Fund pursuant to Rule 4.7(a) notwithstanding that not all participants in the Fund will be QEPs; (2) Y if it does not comply with the Ten Percent Limitation on the amount of Fund assets that may be invested in Investee Pools (3) the CPO of any Investee Pool based upon the Fund's investment of more than ten percent of its assets in that Investee Pool; and (4) Y if it does not provide quarterly reports to Fund participants as is otherwise required by Rule 4.7(a)(2)(ii). Y or an affiliated, registered CPO may also claim all the aforementioned relief in connection with future funds for which it will serve as the CPO and for which the same category of investors will be able to participate. In addition, the Division will not recommend that the Commission take any enforcement action under Rule 4.7(b) against Z or other CTAs retained by the Fund if they treat the Fund as a QEC as defined in Rule 4.7(b).

This letter is based upon the representations made in your correspondence. 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 Y, Z, the CTAs retained by the Fund, or the Fund itself, including the composition of its investors, change in any way from those represented to us.

The relief granted by this letter relieves Y, Z, and other CTAs retained by the Fund solely from certain requirements of Rule 4.7 in connection with the operation and advisement of the Fund, respectively, and does not excuse them from compliance with any other applicable requirements contained in the Commodity Exchange Act (the Act) or in the Commission's regulations issued thereunder. For example, Y, Z, and the other CTAs retained by the Fund remain subject to the antifraud provisions of Section 40 of the Act,⁴ to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's regulations, and to all other applicable provisions of Part 4.

This letter represents the positions of this 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 this correspondence, please contact me or Monica S. Amparo, an attorney on my staff, at (202) 418-5450.

Very truly yours,

Susan C. Ervin

Acting
Director

¹ Commission rules referred to herein are found at 17 C.F.R. Ch. I (1997).

² Commission records indicate that W , which is registered under the Commodity Exchange Act as a futures commission merchant, CPO and CTA, does business as Z .

³ Footnote redacted.

⁴ 7 U.S.C. § 6o (1994).