

**CFTC Letter No. 98-14****February 27, 1998****Division of Trading & Markets**

Re: Request for Exemptive Relief from Rules 4.21, 4.22 (a) and (b), 4.25, and 4.26.

Exemptive Relief Allowing Treatment of Certain Investors as Qualified Eligible Participants

Dear :

This is in response to your letter, dated November 14, 1997, to the Division of Trading and Markets of the Commodity Futures Trading Commission ("Commission"), as supplemented by letters dated January 6 and January 7, 1998 and telephone conversations with Division staff. By your correspondence, you request confirmation of the exemptive relief from the requirements of Rules 4.21, 4.22(a) and (b), 4.25 and 4.26 ("Rules")<sup>1</sup> the Division previously issued to "X", a registered commodity pool operator ("CPO"),<sup>2</sup> with regard to ("Insider Fund"), a commodity pool operated by "X". You also request exemptive relief that would permit the participants in the Insider Fund to allocate a portion of their capital to ("Outsider Fund"), another commodity pool operated by "X", and thus be treated as if they satisfy the qualified eligible participant ("QEP") criteria of Rule 4.7(a).<sup>3</sup>

The Insider Fund

Based upon the representations made in your correspondence, we understand the relevant facts concerning the Insider Fund to be as follows. The Insider Fund began trading as of January 1, 1996 and was formed for the purpose of permitting investment by the principals and employees of "X" and its affiliate, ("X" Advisors"),<sup>4</sup> and certain members of their immediate families. By letters dated November 4, 1996, March 24, 1997, June 2, 1997 and October 29, 1997, the Division granted "X's" requests for exemption from compliance with Rules 4.21, 4.22(a) and (b), 4.24, 4.25 and 4.26 in connection with the operation of the Insider Fund.<sup>5</sup> You now seek confirmation that "X" may continue to claim relief from the Rules if it permits certain changes in the ownership composition of the Insider Fund.

You request that "B", who is currently a limited partner of the Insider Fund and is the sister-in-law of "A", the controlling principal of "X" and "X" Advisors, be permitted to transfer her interest to her husband, "F". "F", who is the brother of "A", is a certified public accountant and an accredited investor under Regulation D of the Securities Act of

1933. In support of this request, you represent that "X" will: (1) provide "F" with a copy of the Insider Fund's Limited Partnership Agreement and Private Placement Memorandum; (2) obtain written confirmation that "F" has received, read, and understood the Private Placement Memorandum; (3) provide "F" with quarterly financial statements and audited annual financial statements;<sup>6</sup> (4) notify "F" that the Insider Fund is being operated pursuant to exemptive relief granted by the Division; (5) explain the nature and purpose of the exemptive relief; (6) obtain a written acknowledgment from "F" that he does not object to the Insider Fund's operation pursuant to exemptive relief; and (7) provide "F" with access to the Insider Fund's books and records.

You further request that "C" and "D", limited partners of the Insider Fund, be permitted to maintain their investments in the Insider Fund notwithstanding the termination of employment with "X" Advisors of "C" and "E", "D's" spouse.<sup>7</sup> In support of this request, you represent that "C" and "E", through a subadvisory agreement between "X" Advisors and "Y", a firm jointly owned by "C" and "E", continue to manage the same subaccount they managed while they were employees of "X" Advisors. You further represent that "D" is a qualified eligible participant ("QEP") and "a sophisticated investor fully capable of evaluating the risks of an investment in the Insider Fund without the full disclosure and reporting safeguards of the Commodity Exchange Act and the Commission's regulations."

### The Outsider Fund

Based upon the representations made in your correspondence, we understand the relevant facts concerning the Outsider Fund to be as follows. The Outsider Fund began trading as of January 1, 1996 and is currently being operated as a Rule 4.7 exempt pool.<sup>8</sup> By letters dated September 30, 1996, March 26, 1997, and October 29, 1997, the Division granted "X's" request to admit certain Non-QEPs into the Outsider Fund.<sup>9</sup> "X" now seeks to admit each of the limited partners of the Insider Fund (the "Proposed Non-QEP Participants") into the Outsider Fund.<sup>10</sup>

The principal difference between the Insider Fund and the Outsider Fund is that the Outsider Fund provides greater diversification to its participants than the Insider Fund. The Insider Fund, unlike the Outsider Fund, is not operated pursuant to a Rule 4.7 exemption. Nonetheless, the relief provided to "X" in connection with its operation of both of these Funds is similar. Thus, for example, "X" is exempt from the specified disclosure provisions and periodic unaudited reporting requirements of Rules 4.21, 4.22(a) and (b) with respect to its operation of both the Insider Fund and the Outsider Fund. Moreover, although "X" is subject to the annual reporting requirements set forth in Rule 4.22(c) with respect to the Insider Fund and is exempt from some of these requirements in connection with the Outsider Fund, "X" nonetheless provides all participants in the Outsider Fund with certified annual reports that comply with the requirements of Rule 4.22(c). To this extent, the Proposed Non-QEP Participants will receive virtually the same certified annual accounting and financial data concerning the Outsider Fund that is provided to them as

participants in the Insider Fund.

In support of your request to allow the Proposed Non-QEP Participants in the Insider Fund to invest in the Outsider Fund, you represent that each of the Proposed Non-QEP Participants is "involved in the trading or management of one or more of the subaccounts through which the Outsider Fund invests in securities and/or commodity interests or is related to someone so involved." You also note that the Division has previously granted "X" relief from the Rules concerning the investments in the Insider Fund for all but one of the Proposed Non-QEP Participants, "F", an accredited investor discussed above.<sup>11</sup> With respect to "F" and the other Proposed Non-QEP Participants, you represent that "X" will obtain the written consent of each participant to be treated as a QEP and will provide each such participant with access to the Outsider Fund's books and records.

Based upon the foregoing representations, it appears that granting the requested relief would not be contrary to the public interest. Accordingly, under authority delegated to it by Rule 140.93(a)(1), the Division hereby confirms that "X" may continue to claim exemptive relief from the Rules in connection with its operation of the Insider Fund notwithstanding the participation therein of "F" and "C" and "D". The Division also grants "X" an exemption such that it may continue to claim relief pursuant to Rule 4.7(a) notwithstanding investment by the Proposed Non-QEP Participants in the Outsider Fund, and may treat the Proposed Non-QEP Participants as QEPs.

The relief granted by this letter does not excuse "X" from compliance with any otherwise applicable requirements contained in the Commodity Exchange Act (the "Act") or in the Commission's regulations thereunder. For example, "X" remains subject to Section 4*o* of the Act,<sup>12</sup> the reporting requirements for traders set forth in Parts 15, 18, and 19 of the Commission's regulations, and all other provisions of Part 4. Moreover, this relief is applicable to "X" solely in connection with its operation of the Insider Fund and the Outsider Fund, as discussed above.

This letter, and the exemption granted herein, are based both upon the representations you have made to us and any conditions stated above, and are applicable to "X" solely in connection with its service as the CPO of the Insider Fund and the Outsider Fund. Any different, changed or omitted material facts or circumstances might render this exemption void. You must notify us immediately in the event the operations or activities of "X", the Insider Fund, or the Outsider Fund, including the composition of either Fund's investors, change in any material way from those as represented to us. Further, this relief is prospective only. Since both the Insider Fund and the Outsider Fund began operating prior to this grant of relief, nothing herein should be construed as limiting in any way the Commission's ability to institute enforcement proceedings or other action against "X" for any past violation of the Act or Commission regulations.

If you have any questions concerning this correspondence, please contact Helene D. Schroeder, an attorney on my staff, at (202) 418-5450.

Very truly yours,

I. Michael Greenberger

Director

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

<sup>2</sup> "X" also is registered as a commodity trading advisor ("CTA").

<sup>3</sup> We note, at the outset, that some of the participants in the Insider Fund are QEPs. As "X" can continue to claim relief from Rule 4.7(a) notwithstanding the participation of such QEPs, we interpret your request as seeking exemptive relief to treat as QEPs only those persons who are not QEPs.

<sup>4</sup> "X" Advisors is registered as a CTA and CPO and serves as co-investment manager of the Insider Fund. Its sole managing member is "A", who also is "X's" sole managing member and is individually registered as a CPO.

<sup>5</sup> Initially, because interests in the Insider Fund had been privately offered and sold under Section 4(2) of the Securities Act of 1933, as amended, and Regulation D thereunder, the Insider Fund was operated pursuant to an exemption under Rule 4.12(b). As such, the Insider Fund could not invest more than ten percent of its assets in commodity interests. On November 4, 1996, "X" obtained exemptive relief from Rules 4.21, 4.22(a) and (b), 4.24, 4.25 and 4.26 as it wished to invest more than ten percent of its assets in commodity interests and still be exempt from certain disclosure and monthly reporting requirements of Part 4. CFTC Interpretative Letter No. 96-82, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,911 (November 4, 1996). Thereafter, on March 24, 1997, June 2, 1997, and October 29, 1997, "X" obtained confirmation of the exemptive relief that had been previously granted from the Rules notwithstanding investment in the Insider Fund of certain additional limited partners. *See* CFTC Interpretative Letters No. 97-18, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,010 (March 24, 1997) and No. 97-90, to be published in Comm. Fut. L. Rep. (CCH) (October 29, 1997).

<sup>6</sup> In this regard, we note that "X" is subject to the Annual Report requirement of Rule 4.22(c) in connection with its operation of the Insider Fund.

<sup>7</sup> In response to staff inquiries, you explained that you inadvertently omitted "D" from the request for relief from the Rules in connection with the Insider Fund that you made on July 31, 1996.

Thus, staff were unaware of "D's" participation in the Insider Fund when relief was granted on November 4, 1996. Notwithstanding your omission in connection with the July 31, 1996 relief request, you represent that "D" has received the Limited Partnership Agreement of the Insider Fund, the Private Placement Memorandum, quarterly financial statements, and audited annual financial statements.

With respect to the omission of "D" in your July 31, 1996 letter, any relief granted by this letter is prospective only. Nothing in this letter should be construed as limiting in any way the Commission's ability to institute enforcement proceedings or other action against "X" for any past violation of the Act or Commission rules as a result of the omission of "D" from the prior request.

<sup>8</sup> Commission records indicate that "D" filed a notice of claim for exemption under Rule 4.7 on behalf of the Outsider Fund on December 31, 1996.

<sup>9</sup> CFTC Interpretative Letters No. 96-69, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,795 (September 30, 1996); No. 97-28, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,038 (March 26, 1997); No. 97-90, *supra* note 5.

<sup>10</sup> As previously stated, *supra* note 3, some of the limited partners are QEPs, and thus "X" can continue to claim relief notwithstanding the participation of such partners and need not seek specific authorization to admit such persons into the Outsider Fund.

<sup>11</sup> Actually, you represent that the Division had previously granted relief with respect to the investments of all but two of the Proposed Non-QEP Participants, "F" and "D". However, since "D" is a QEP, "X" would be entitled to continue to claim relief from the Rules notwithstanding her participation.

<sup>12</sup> 7 U.S.C. § 6o (1994).