

CFTC Letter No. 98-20**March 24, 1998****Division of Trading & Markets**

Re: Section 4m(1) of the Commodity Exchange Act -- Request for no-action position regarding CPO registration where an affiliated registered CPO performs the pool's CPO functions.

Rule 4.7(a) -- Request for exemption to permit participation in a Rule 4.7(a) exempt pool by a non-QEP trust established for the benefit of the mother of an existing participant.

Rule 4.7(a) -- Request for interpretation that persons meeting the "knowledgeable employee" definition in Investment Company Act Rule 3c-5 be deemed to be qualified eligible participants ("QEPs") for purposes of Commission Rule 4.7(a).

Dear :

This is in response to your letter dated September 3, 1997, to the Division of Trading and Markets (the "Division") of the Commodity Futures Trading Commission (the "Commission"), as supplemented by your facsimile transmissions dated October 1, 1997, October 14, 1997, October 22, 1997, November 5, 1997, November 14, 1997 and March 10, 1998 and by telephone conversations with Division staff. By your correspondence, you request that the Division agree not to recommend enforcement action: (1) if "S" does not register as a commodity pool operator ("CPO") in connection with serving as the general partner of "U", a pool as to which exemption has been claimed under Commission Rule 4.7(a) (the "Pool");¹ (2) if "T", a registered CPO under common ownership with "S", serves as the Pool's CPO; (3) if "T" admits as a participant in the Pool, (the "Trust"), a trust established for the benefit of "A" (the mother of "B", an existing participant in the Pool), notwithstanding that the Trust is not a qualified eligible participant ("QEP") as defined in Rule 4.7(a); and (4) if "T" continues to claim exemption under Rule 4.7(a) with respect to the Pool, notwithstanding future investment in the Pool of persons who are not QEPs, but who are "knowledgeable employees" as defined in Rule 3c-5 under the Investment Company Act of 1940 (the "ICA").²

Based upon the representations contained in your correspondence, we understand the pertinent facts to be as follows. The respective general partners of "S" and "T" are limited partnerships of which the sole general partner is "V". The Pool commenced operations in

1991, at which time "S" was registered as a CPO and served as the Pool's CPO. Prior to January 1, 1996 all of the persons responsible for the Pool's investment decisions were directly employed by the Pool. From January 1, 1996 onward, those persons ceased to be employees of the Pool and became employees instead of a newly-formed management company ("T"). "T" had been formed and registered as a CPO in anticipation of the establishment of "W", a Cayman Islands-domiciled investment fund functionally similar to the Pool but open only to non-United States persons. You believed that formation of "T" would eliminate certain conflicts of interest that would have arisen if "W" were managed by employees of the Pool. Thus, beginning March 1, 1996, while "S" continued to be the registered CPO of the Pool, "T" began serving as the registered CPO of "W".

In 1997, because "S" had no employees (while "T" employed all of the persons responsible for investment decisions and regulatory compliance for the Pool, as well as for "W") and on advice from outside counsel, you determined to have "T" "assume all CPO responsibilities for the Pool" and to treat "T" as the CPO of both the Pool and "W". You withdrew "S"'s CPO registration effective June 22, 1997.³

CPO Registration. Ordinarily where a pool is organized as a limited partnership, the general partner is deemed to be the CPO thereof and must register as such⁴. In support of your request that "S" should not be required to register as a CPO on account of its position as the Pool's general partner, you have provided a written acknowledgment by "S" of joint and several liability with "T" for any violations of the Commodity Exchange Act (the "Act")⁵ or Commission rules. Based upon this acknowledgment, together with your representations that "T": (1) is a registered CPO; (2) has all CPO responsibilities for the Pool; and (3) is ultimately controlled by the same parent as "S" (i.e., "V"), the Division will not recommend that the Commission commence any enforcement action under Section 4m(1) against "S" or "T" in connection with the failure of "S" to register as a CPO or in connection with "T" serving in lieu of "S" as the CPO of the Pool.

Participation of the Trust in the Pool. The Trust's sole trustee is "B", a participant in the Pool who is a partner of the general partner of "S" and a partner of the general partner of "T". "B" has been employed by "T" (or the Pool) for the past five years, he is one of seven individuals responsible for running "T", and he is responsible for managing approximately \$200 million of equity capital for "T". "B" also is directing the investment in the Pool on behalf of the Trust.

"B" anticipates that not more than 30-40% of the Trust's assets will be invested in the Pool. Because the Trust's assets represent approximately 30% of his mother's net worth, the proposed investment in the Pool should not exceed 15% of "A"'s net assets.

In support of your request that the Trust be permitted to participate in the Pool, you also represent that:

1. The Trust and its beneficiary are accredited investors, and the trustee ("B") is a QEP;
2. The Trust has consented to being treated as a QEP; and
3. The Trust will have access to all information pertinent to an investment in the Pool.

Based upon the foregoing, it appears that granting the requested relief would not be contrary to the public interest or the purposes of Rule 4.7. Accordingly, by the authority delegated to it under Rule 140.93(a)(1), the Division hereby grants an exemption such that "T" may continue to claim relief pursuant to Rule 4.7(a), notwithstanding investment by the Trust in the Pool, and may treat the Trust as a QEP.

QEP Treatment of "Knowledgeable Employees."

As you know, the requirement that all participants in a Rule 4.7(a) exempt pool must be QEPs is not currently subject to an exception analogous to the "knowledgeable employee" exception under the Investment Company Act. In light of the important customer protection issues at stake, Division staff believe that notice and comment rulemaking is the appropriate procedure for evaluating whether "knowledgeable employees" of a pool should be treated as QEPs under Rule 4.7(a). To that end, we invite you to file a petition for rulemaking on this issue or to comment on any future rulemaking initiated by the Commission or by another industry participant. In the interim, we will consider on a case-by-case basis requests to treat as QEPs persons who meet the SEC's "knowledgeable employee" criteria but who do not fit the QEP definition.

This letter does not excuse "S", "T" or the Pool from compliance with any other applicable requirements contained in the Act or in the Commission's regulations issued thereunder. For example, "S" and "T" remain subject to the antifraud provisions of Sections 4b and 4c of the Act,⁶ to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's rules, and to all otherwise applicable provisions of Part 4. Moreover, this letter is applicable to "S" and "T" solely in connection with the operation of the Pool, as discussed above.

This letter, and the positions taken and exemption granted herein, is based upon the representations that have been made to us, and is subject to compliance with the condition set forth above. Any different, changed or omitted facts or circumstances might render void the no-action position and/or exemption. You must notify us immediately in the event that the operations or activities of "S", "T", the Pool or the Trust change in any respect from those as represented to us.

Nothing in this letter should be construed as limiting in any way the Commission's ability

to proceed against "V", "S" or "T" or their respective principals for any past violation of the Act or of the Commission's regulations thereunder. If you have any questions concerning this correspondence, please contact me or Christopher W. Cummings, an attorney on my staff, at (202) 418-5450.

Very truly yours

I. Michael Greenberger

Director

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

² 15 U.S.C. § 80a-1 et seq. (1994). As an alternative to the Division taking a no-action position concerning admission of "knowledgeable employees" as participants in the Pool, you request that the Division issue a formal exemption permitting CPOs of Rule 4.7 exempt pools from the requirement to restrict such pools' participants to QEPs to the extent that they admit participants who are "knowledgeable employees."

³ You further represent that you notified the National Futures Association ("NFA") "of this decision and, at the request of the NFA, provided the NFA with a copy of a notice that [you] distributed to all partners of [the Pool] in which the change of CPO was described. The NFA thereafter issued notice of termination of "S"."

⁴ See CFTC Interpretative Letter No. 75-16, [1975-1976 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,104 (October 15, 1975).

⁵ 7 U.S.C. § 1 et seq. (1994).

⁶ 7 U.S.C. § 6b and 6o (1994).