

CFTC Letter No. 98-49

June 12, 1998

Division of Trading & Markets

Re: Rule 4.7(a) -- Request for an Exemption to Treat Prospective Investors as Qualified Eligible Participants and for an Exemption from the Ten Percent Limitation on Assets Invested in Exempt Pools

Dear :

This is in response to your letter dated February 16, 1998 to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by letter dated March 30, 1998, facsimile dated April 18, 1998 and telephone conversations with Division staff. By your correspondence, you request an exemption from Rule 4.7(a) on behalf of "H", a registered commodity pool operator¹ and the general partner of the "Fund", so that six investors in the Fund may be treated as if they satisfy the qualified eligible participant ("QEP") criteria of Rule 4.7(a).² You also seek an exemption from the ten percent investment limitation of Rule 4.7(a)(1)(ii)(B)(2) (xi) (the "Ten Percent Limitation") in connection with "H's" operation of the Fund.

Based upon your representations, we understand the facts to be as follows. The Fund is the successor to "I", an limited partnership formed in 1982, prior to the adoption of Rule 4.7.³ It had several investors that were not QEPs. However, through the filing by "H" of a Notice of Exemption ("Notice"), the Fund agreed to admit only QEPs in the future. In its Notice, "H" also claimed relief from only the disclosure requirements of Rules 4.21, 4.24, 4.25 and 4.26 but not from the reporting requirements of Rules 4.22(a) and (b) or the recordkeeping requirements of Rule 4.23.

"H" now seeks to admit six individuals who are not QEPs. Each of these individuals is employed as a trader or portfolio manager for "J", a registered futures commission merchant, commodity trading advisor and securities broker-dealer that provides securities brokerage services for the Fund. The six individuals (the "Proposed Non-QEP Participants") also provide similar services for "J's" affiliates, "H" and "K".⁴ "K" is a CTA that advises "X", an offshore fund into which the Fund invests a substantial portion of its capital. The Proposed Non-QEP Participants technically are not employees of "H" or "K"; however, both entities pay "J" the work performed for them by the Proposed Non-QEP Participants. In their role as traders and portfolio managers for "H", the six individuals assist the principals of "H" in devising and implementing trading strategies and opportunities for the Fund. The Proposed Non-QEP Participants are as follows:

(1) "A", who joined "J" as a trader in 1996. "A" also has served as a trader for "H" and "K". Before he joined "J", from 1990 until 1996, "A" was a vice president and trader for "L", an investment bank, and "M", the branch of "L". From 1990 until 1994, "A" was responsible at these firms for building the structured note and asset swap business and from 1994 until 1996, he was responsible for the emerging market derivatives practice. "A" also has a BS degree in Mechanical Engineering and is an accredited investor under Regulation D of the Securities Act of 1933.

(2) "B", who joined "J" as a portfolio manager in 1996. At "J", "B" manages "J's" G-7 portfolio. He also has served as a trader for "H" and "K". Before he joined "J", from 1991 until 1996, "B" was the director of the interest rate swap desk for "N", a securities broker-dealer. Between 1987 until 1989, he worked as a senior consultant on systems for financial institutions for "O" and "P", a large accounting firm. "B" also has an MBA in Finance from the "Q" School of Business and is an accredited investor.

(3) "C", who joined "J" as a trader and analyst in 1996. At "J", "C" trades options and other fixed income instruments and provides analytical forecasting and trading strategy modeling. He also has served as a trader and analyst for "H" and "K". Before joining "J", from 1986 until 1995, "C" was a vice president for "R", a securities broker-dealer. At "R", "C" was responsible for trading U.S. government, mortgage and non-dollar government options. "C" also has a BS in Electrical Engineering, an MS in computer science and is an accredited investor.

(4) "D", who joined "J" as a mortgage trader and portfolio manager in 1995. In addition to his portfolio management duties, "D" designs derivative and synthetic discount trades for "J", "H" and "K". Before joining "J", between 1985 and 1995, "D" worked as a portfolio manager for "S", a publicly-traded bank and financial services holding company, "T", a registered investment adviser for mutual and pension funds, "U", an exempt investment adviser for mutual funds, and "V", another exempt investment adviser. He has a BA in finance, is an accredited investor, and is registered as an associated person ("AP") of "J".

(5) "E", who joined "J" as a portfolio manager in 1995. "E" also has served as a trader for "H" and "K". Before he joined "J", from 1993 until 1995, "E" worked for "S" as a vice president and portfolio manager. He has a BA in finance and economics, an MA in Economics and an MBA. "E" also is an accredited investor.

(6) "F", who joined "J" as a trader in 1994. "F" also has served as a trader for "H" and "K". At "J", "F" trades government bonds, futures, options and interest rate swaps in domestic and overseas markets. Before joining "J", from June 1990 until May 1994, "F" was a vice president for proprietary trading with "W", a securities

broker-dealer. At "W", "F" traded interest rate futures and options. "F" has an MBA in finance, is an accredited investor and is a registered AP of "J".

In support of your request, you assert that "[b]y virtue of their work with "H", [the Proposed Non-QEP Participants] are all intimately familiar with the trading strategies employed by, and the associated risks of, investing in the Fund, and they all have ready access to all information pertinent to an investment in the Fund." You further assert that each of the Proposed Non-QEP Participants will consent to being treated as a QEP for purposes of investment in the Fund and to a waiver of the Ten Percent Limitation for investment of the Fund's assets in other exempt pools.

Based upon the foregoing, it appears that granting your request would not be contrary to the public interest or the purposes of Rule 4.7(a). Accordingly, by the authority delegated to it under Rule 140.93(a)(1), the Division hereby grants "H" an exemption such that it may treat the Proposed Non-QEP Participants as QEPs and continue to claim relief pursuant to Rule 4.7(a) notwithstanding their investment in the Fund. "H" further is permitted, notwithstanding the investments by the Proposed Non-QEP Participants, to invest more than ten percent of the fair market value of the Fund's assets in other Rule 4.7(a) exempt pools.

This letter does not excuse "H" from compliance with any otherwise applicable requirements contained in the Commodity Exchange Act (the "Act") or in the Commission's regulations thereunder. For example, "H" remains subject to all antifraud provisions of the Act and the Commission's regulations, the reporting requirements for traders set forth in Parts 15, 18, and 19 of the regulations, and all other provisions of Part 4. Moreover, this letter is applicable to "H" solely in connection with its operation of the Fund, as discussed above.

This letter, and the exemptions granted herein, are based upon the representations you have made to us. Any different, changed or omitted material facts or circumstances might render these exemptions void. You must notify us immediately in the event the operations or activities of "H" or the Fund, including the composition of the investors in the Fund, change in any material way from those as represented to us.

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

¹ "H" also is registered as a commodity trading advisor ("CTA").

² Commission rules referred to herein are found at 17 C.F.R. Ch. I (1997).

³ In this regard, and based upon the CFTC's Advisory for Interpretative Letters Nos. 93-1 and 93-2, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,935 (Jan. 7, 1993), "H" claimed relief from the disclosure requirements of Rules 4.21, 4.24, 4.25 and 4.26 but not from the reporting requirements of Rules 4.22(a) and (b) or the recordkeeping requirements of Rule 4.23. The Advisory permitted CPOs for certain pools, the participants in which included both QEPs and non-QEPs prior to the adoption of Rule 4.7, to claim relief from Rule 4.7, provided, among other things, that the CPOs agreed, prospectively, to admit only QEPs into the pools.

⁴ "J", "H" and "K" are affiliated through common ownership. The three principals of "J" are the sole shareholders of three of the five corporations which serve as general partners of "H" and "K".