

term debt or in an equivalent short-term category (within either of which there may be sub-categories or gradations indicating relative standing) by one or more nationally recognized statistical rating organizations; or

(ii) Which are sold in transactions by an issuer not involving any public offering for purposes of section 4 of the Securities Act of 1933, as amended, or in transactions exempt from registration under such Act under 17 CFR 230.901 through 230.905 (Regulation S) thereunder (or any successor regulation).

(6) *Special purpose entity* means a trust, corporation, or other entity with a distinct standing at law separate from the federally-insured credit union that is primarily engaged in acquiring and holding (or transferring to another special purpose entity) financial assets, and in activities related or incidental thereto, in connection with the issuance by such special purpose entity (or by another special purpose entity that acquires financial assets directly or indirectly from such special purpose entity) of beneficial interests.

(b) The Board, by exercise of its authority to disaffirm or repudiate contracts under 12 U.S.C. 1787(c), will not reclaim, recover, or recharacterize as property of the credit union or the liquidation estate any financial assets transferred to another party by a federally-insured credit union in connection with a securitization or participation, provided that a transfer meets all conditions for sale accounting treatment under generally accepted accounting principles, other than the "legal isolation" condition addressed by this section.

(c) Paragraph (b) of this section will not apply unless the federally-insured credit union received adequate consideration for the transfer of financial assets at the time of the transfer, and the documentation effecting the transfer of financial assets reflects the intent of the parties to treat the transaction as a sale, and not as a secured borrowing, for accounting purposes.

(d) Paragraph (b) of this section will not be construed as waiving, limiting, or otherwise affecting the power of the Board, as conservator or liquidating agent, to disaffirm or repudiate any agreement imposing continuing obligations or duties upon the federally-insured credit union in conservatorship or the liquidation estate.

(e) Paragraph (b) of this section will not be construed as waiving, limiting or otherwise affecting the rights or powers of the Board to take any action or to

exercise any power not specifically limited by this section, including, but not limited to, any rights, powers or remedies of the Board regarding transfers taken in contemplation of the credit union's insolvency or with the intent to hinder, delay, or defraud the credit union or the creditors of such credit union, or that is a fraudulent transfer under applicable law.

(f) The Board will not seek to avoid an otherwise legally enforceable securitization agreement or participation agreement executed by a federally-insured credit union solely because such agreement does not meet the "contemporaneous" requirement of sections 207(b)(9) and 208(a)(3) of the Federal Credit Union Act.

(g) This section may be repealed by the NCUA upon 30 days notice and opportunity for comment provided in the **Federal Register**, but any such repeal or amendment will not apply to any transfers of financial assets made in connection with a securitization or participation that was in effect before such repeal or modification. For purposes of this paragraph, a securitization would be in effect on the earliest date that the most senior level of beneficial interests is issued, and a participation would be in effect on the date that the parties executed the participation agreement.

4. Add § 709.11 to part 709 to read as follows:

**§ 709.11 Treatment by conservator or liquidating agent of collateralized public funds.**

An agreement to provide for the lawful collateralization of funds of a federal, state, or local governmental entity or of any depositor or member referred to in section 207(k)(2)(A) of the Act will not be deemed to be invalid under section 208(a)(3) of the Act solely because such agreement was not executed contemporaneously with the acquisition of collateral or with any changes in the collateral made in accordance with such agreement.

[FR Doc. 00-4852 Filed 3-1-00; 8:45 am]

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**COMMODITY FUTURES TRADING COMMISSION**

**17 CFR Part 4**

**RIN 3038-AB37**

**Exemption for Commodity Pool Operators With Respect to Offerings to Qualified Eligible Participants; Exemption for Commodity Trading Advisors With Respect to Advising Qualified Eligible Clients**

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Proposed rule.

**SUMMARY:** The Commodity Futures Trading Commission ("Commission") is proposing to revise Commission Rule 4.7 ("Proposal").<sup>1</sup> Rule 4.7 provides a simplified regulatory framework for commodity pool operators ("CPOs") operating commodity pools consisting of certain highly accredited pool participants, termed "qualified eligible participants" ("QEPs"), and for commodity trading advisors ("CTAs") directing or guiding the commodity interest trading accounts of certain highly accredited clients, termed "qualified eligible clients" ("QECs"). The Proposal would revise the rule both substantively and technically.

The proposed substantive revisions are intended to make Rule 4.7 available to more CPOs and CTAs and under more situations, by bringing within the scope of the rule those additional persons who the Commission now believes should be included in the QEP and QEC definitions. The Proposal would add, among others, the following persons to the existing QEP and QEC definitions: Principals of the registered investment professionals currently defined as QEPs and QECs; certain registered securities investment advisers and their principals; "qualified purchasers" and "knowledgeable employees" as those terms are defined under the federal securities laws; certain employees of pools, CPOs and CTAs and certain of those employees' immediate family members; and trusts whose advisors and settlors are QEPs or QECs. In addition, the Proposal would make it easier for certain charitable organizations, trusts and collective investment vehicles to be QEPs and QECs, and, under certain circumstances, it would include persons who are not "United States persons" in the QEC definition. Certain of the proposed technical revisions, *i.e.*, those which would reorganize the rule, are intended

<sup>1</sup> Commission rules referred to herein are found at 17 CFR Ch. I.

to facilitate a determination of whether a person is (or is not) a QEP or a QEC. Other proposed technical revisions would conform various references in the existing rule to those in the proposed rule.

In light of the breadth of the proposed revisions, the Commission is publishing for comment in this release the entire text of Rule 4.7 as it would appear if the Commission's proposed amendments were adopted. The Commission also is including in this release a chart that compares the provisions of the proposed rule with the provisions of the existing rule.

**DATES:** Comments must be received on or before May 1, 2000.

**ADDRESSES:** Comments on the proposed rule should be sent to Jean A. Webb, Secretary, Commodity Futures Trading Commission, Three Lafayette Center, 1155 21st Street NW, Washington, DC 20581. Comments may be sent by facsimile transmission to (202) 418-5528, or by e-mail to [secretary@cftc.gov](mailto:secretary@cftc.gov). Reference should be made to "Proposed Amendments to Rule 4.7."

**FOR FURTHER INFORMATION CONTACT:** Barbara Stern Gold, Assistant Chief Counsel, or Helene D. Schroeder, Attorney-Advisor, Division of Trading and Markets, Commodity Futures Trading Commission, 2033 K Street NW, Washington, DC 20581. Telephone: (202) 418-5450.

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**I. Background**

*A. Regulation of CPOs and CTAs Under the Commodity Exchange Act*

Section 4m(1) of Commodity Exchange Act (the "Act")<sup>2</sup> requires each person who comes within the definition of the term "commodity pool operator" in Section 1a(4) of the Act<sup>3</sup> or "commodity trading advisor" in Section 1a(5) of the Act<sup>4</sup> to register with the Commission as a CPO or CTA, respectively, or to satisfy the requirements for exemption from such registration.<sup>5</sup> Part 4 of the Commission regulations<sup>6</sup> relates to the operations and activities of CPOs and CTAs. Part 4 includes disclosure, reporting and recordkeeping requirements for CPOs (Rules 4.21 through 4.26) and disclosure and recordkeeping requirements for CTAs (Rules 4.31 through 4.36). In addition, regardless of registration status, Rules 4.20 and 4.30 prohibit certain activities by CPOs and CTAs, respectively, and Rule 4.41 sets forth certain advertising requirements for CPOs, CTAs and the principals thereof.

The Commission has endeavored to construct a regulatory framework for CPOs and CTAs that avoids unnecessary burdens while, at the same time, maintains customer protection. From time to time the Commission has refined that framework as appropriate to respond to changing market conditions and to simplify and to streamline the regulatory structure without creating regulatory gaps.<sup>7</sup>

*B. Rule 4.7*

In 1992, the Commission adopted Rule 4.7 as part of the Commission's

<sup>2</sup> 7 U.S.C. 6m(1) (1994).

<sup>3</sup> 7 U.S.C. 1a(4) (1994).

<sup>4</sup> 7 U.S.C. 1a(5) (1994).

<sup>5</sup> Rule 4.13 provides exemption from CPO registration for the persons specified therein. Section 4m(1) of the Act, 7 U.S.C. 6m(1) (1994), and Rule 4.14 provide exemption from CTA registration for the persons specified therein.

<sup>6</sup> Part 4 includes Rules 4.1-4.41.

<sup>7</sup> See, e.g., Rules 4.5, 4.12(b) and 4.14(a)(8), which provide exceptions from registration or particular Part 4 requirements based upon, among other things, the applicability of another federal regulatory framework to the CPO or CTA. Rule 4.5 was published at 50 FR 15868 (Apr. 23, 1985); Rules 4.12(b) and 4.14(a)(8) were published at 52 FR 41975 (Nov. 2, 1987).

ongoing program for review of its rules.<sup>8</sup> Rule 4.7(a) provides an exemption from certain disclosure, reporting and recordkeeping requirements for registered CPOs in connection with their operation of commodity pools whose participants are QEPs. The exemption provides relief from all of the specific disclosures required by Rules 4.21 and 4.24 through 4.26 and streamlines the reporting and recordkeeping requirements of Rules 4.22 and 4.23, respectively. In proposing Rule 4.7(a), the Commission stated that it had the dual objective, consistent with its customer protection role, of:

(1) Reducing unnecessary regulatory prescriptions for CPOs offering pool participations only to persons who, based upon the qualifying criteria in the proposed rule, do not appear to need the full protections offered by the part 4 framework; and (2) coordinating its rules with those of the [Securities and Exchange Commission] applicable to private offerings exempt from registration pursuant to Section 4(2) of the Securities Act so that most qualifying offerings may operate under an exemption from otherwise applicable requirements of both the Commodity Exchange Act and the securities laws.<sup>9</sup>

Under Rule 4.7(a), however, a registered CPO operating a pool for which it has claimed Rule 4.7 relief ("exempt pool") remains subject to all other applicable requirements of the Act and the Commission's regulations issued thereunder with respect to the exempt pool and any other pool the CPO operates or intends to operate.<sup>10</sup> For example, it remains subject to the antifraud provisions of Sections 4b and 4c of the Act,<sup>11</sup> the prohibited activities and advertising provisions applicable to CPOs in Rules 4.20 and 4.41, respectively, and the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's regulations. Moreover, if a CPO distributes an offering memorandum in connection with soliciting participations in an exempt pool, the memorandum must include all disclosures necessary to make the information contained therein, in the context in which it is furnished, not misleading.<sup>12</sup>

<sup>8</sup> 57 FR 34853 (Aug. 7, 1992). The Commission made certain technical, non-substantive amendments to Rule 4.7 in 1995. See 60 FR 38146, 38182 (July 25, 1995). These amendments were necessary to conform certain of the references in Rule 4.7 to other Part 4 rules the Commission had renumbered in connection with revising the disclosure rules generally applicable to CPOs and CTAs.

<sup>9</sup> 57 FR 3148, 3150-51 (Jan. 28, 1992).

<sup>10</sup> Rule 4.7(a)(4).

<sup>11</sup> 7 U.S.C. 6b and 6c (1994).

<sup>12</sup> Rule 4.7(a)(2)(i)(A).

Rule 4.7(b) provides similar relief from the specific disclosure requirements of Rules 4.31 and 4.34 through 4.36 and recordkeeping requirements of Rule 4.33 to registered CTAs who direct or guide the commodity interest trading accounts of QECs ("exempt accounts"). In proposing Rule 4.7(b), the Commission stated that its rationale "is analogous to that for proposing relief for CPOs, *i.e.*, that QEPs are sophisticated investors who have the financial ability and experience necessary to understand the risks of futures trading and to obtain the information they require."<sup>13</sup>

Under Rule 4.7(b), a CTA that has claimed Rule 4.7 relief with respect to a QEC likewise remains subject to all other applicable requirements of the Act and the Commission's regulations with respect to the QEC and any other client to which the CTA provides or intends to provide commodity interest trading advice.<sup>14</sup> Similarly, if a CTA delivers a brochure or other disclosure statement to QECs, the brochure or statement must include all disclosures necessary to make the information contained therein, in the context in which it is furnished, not misleading.<sup>15</sup>

### C. Developments Subsequent to the Adoption of Rule 4.7

Subsequent to the adoption of Rule 4.7, and consistent with the purposes of the rule, Commission staff has permitted a CPO to treat as a QEP and a CTA to treat as a QEC certain persons who did not meet the specified criteria of the rule. Various of these letters are cited *infra* at Part III.

In addition, in 1996, Congress enacted the National Securities Markets Improvement Act of 1996 ("NSMIA").<sup>16</sup> Many collective investment vehicles trade both securities and commodity interests, and absent an exemption, they are subject to registration as an investment company under the Investment Company Act of 1940 (the "ICA") and their operators are subject to registration as a CPO under the Act.<sup>17</sup>

Among other things, NSMIA added Section 3(c)(7) to the ICA<sup>18</sup> thereby providing an additional exemption from the definition of the term "investment company" under the ICA with respect to funds comprised exclusively of qualified purchasers ("QPs"). NSMIA also directed the Securities and Exchange Commission ("SEC") to promulgate rules that would permit ownership by knowledgeable employees of the securities of the issuer (or affiliate) without loss of the issuer's definitional exemption under Section 3(c)(1)<sup>19</sup> or 3(c)(7) of the ICA. In 1997, the SEC adopted Rule 3c-5 under the ICA,<sup>20</sup> which defines the term "knowledgeable employee."<sup>21</sup>

Based upon staff's experience in administering Rule 4.7 and taking into account these recent developments in the federal securities laws, the Commission is proposing to expand the QEP and QEC definitions, which would have the effect of permitting registered CPOs and CTAs to claim relief in additional circumstances under Rule 4.7. In taking this action, the Commission has been guided by the purposes of Rule 4.7. As stated above, with respect to CPOs, these purposes are to: (1) Reduce unnecessary regulatory burdens with respect to persons who appear not to need the full protections of the Part 4 framework; and (2) coordinate the Commission's rules with certain federal securities laws.<sup>22</sup> As for CTAs, the rationale for relief "is analogous to that for \* \* \* CPOs, *i.e.*, that QEPs are sophisticated investors who have the financial ability and experience necessary to understand the risks of futures trading and to obtain the information they require."<sup>23</sup>

The Commission also is proposing to reorganize Rule 4.7. In light of the breadth of the proposed actions, the Commission is publishing in this release the entire text of Rule 4.7 as it would

Investment Company Act of 1940. (Emphasis in original.)

Id. at 78,651.

<sup>18</sup> 15 U.S.C. 80a-3(c)(7) (Supp. III 1997). Section 3(c)(7) is further discussed *infra* at Part III. B.2.c.

<sup>19</sup> 15 U.S.C. 80a-3(c)(1) (1994 & Supp. III 1997). Section 3(c)(1) of the ICA exempts from the definition of investment company any issuer that is not making and does not propose to make a public offering of its securities whose outstanding securities (other than short-term paper) are owned by not more than 100 beneficial owners.

<sup>20</sup> 17 CFR 270.3c-5 (1999).

<sup>21</sup> See 62 FR 17512 (Apr. 9, 1997). According to the SEC, Congress' purpose in directing the SEC to adopt this provision "appears to be to allow privately offered funds to offer persons who participate in the funds' management the opportunity to invest in the fund as a benefit of employment." Id. at 17514 n.22.

<sup>22</sup> See 57 FR at 3150-51.

<sup>23</sup> 23 Id. at 3151.

appear if the proposed rule amendments were adopted. Moreover, to assist interested persons in providing comments on the Proposal, the Commission is including in this release a chart that compares the provisions of the proposed rule with the provisions of the existing rule. This chart is set forth below at Part IV.

## II. Proposed Technical Revisions: Reorganization

### A. Organization of Existing Rule 4.7

Commission staff's experience in administering Rule 4.7 has been that, as the rule currently is organized, CPOs and CTAs frequently have experienced difficulties in determining whether a particular person is a QEP or a QEC. Accordingly, the Commission is proposing to reorganize Rule 4.7 to facilitate these determinations.

Existing Rule 4.7 is divided into three paragraphs. Paragraph (a), captioned "Relief for commodity pool operators," contains provisions relating to the definition of a QEP, the relief a CPO may claim under Rule 4.7, the notice a CPO must file to claim exemption under Rule 4.7 and the effect the filing of the notice has on the CPO's other obligations under the Act and other provisions of the Commission's rules.<sup>24</sup> Paragraph (b), captioned "Relief for commodity trading advisors," contains similar provisions for CTAs.<sup>25</sup> Paragraph (c), captioned "Insignificant deviations from a term, condition or requirement of Rule 4.7," contains provisions relating to a failure to comply with Rule 4.7. Persons have found determining the availability of relief under Rule 4.7 difficult at times because of, among other things, the multiple definitional criteria and the manner in which the text is subdivided under the existing organization.

### B. Proposed Reorganization

Under the Proposal, Rule 4.7 would be reorganized into four paragraphs. Proposed paragraph (a), which would be captioned "Definitions," would contain all of the definitions under Rule 4.7, including both the QEP and QEC definitions. Proposed paragraph (b), which would be captioned "Relief for commodity pool operators," would contain the other existing provisions applicable to CPOs (relief, notice and effect).<sup>26</sup> Proposed paragraph (c), which would be captioned "Relief for

<sup>24</sup> Rules 4.7(a)(1), (2), (3) and (4), respectively.

<sup>25</sup> Rules 4.7(b)(1), (2), (3) and (4), respectively.

<sup>26</sup> Existing paragraphs (a)(2), (a)(3) and (a)(4) would be redesignated as paragraphs (b) and (b)(1), (b)(2) and (b)(3), respectively, with references to existing paragraphs of Rule 4.7 being conformed to refer to the proposed paragraphs.

<sup>13</sup> 57 FR at 3151.

<sup>14</sup> Rule 4.7(b)(4).

<sup>15</sup> Rule 4.7(b)(2)(i)(A).

<sup>16</sup> Pub. L. No. 104-290, 110 Stat. 3416 (codified as amended in scattered sections of 15 U.S.C. and 29 U.S.C.).

<sup>17</sup> See, *e.g.*, Peavey Commodity Futures Funds I, II, III [1983-1984 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 77,511 (June 2, 1983). In discussing certain recent amendments to the federal securities laws concerning the jurisdiction of the SEC and the Commission, staff of the SEC's Division of Investment Management stated:

[A]n entity investing in [futures on certain securities or options on such futures] is not subject to the jurisdiction of the SEC under the Investment Company Act of 1940 unless such entity is otherwise an investment company under the

commodity trading advisors," would contain the other existing provisions applicable to CTAs.<sup>27</sup> Proposed paragraph (d), which would be captioned "Insignificant deviations from a term, condition or requirement of Rule 4.7," would contain the text of existing paragraph (c).<sup>28</sup>

Proposed paragraph (a)(1) would contain the general definitions that would be used throughout Rule 4.7. Proposed paragraphs (a)(2) and (a)(3) would contain the QEP and QEC definitions, respectively, with each of those paragraphs being divided into persons who are QEPs or QECs irrespective of the Portfolio Requirement<sup>29</sup> and persons who must satisfy the Portfolio Requirement to be QEPs or QECs.

The Commission believes that this proposed reorganization will be of great assistance to CPOs and CTAs in determining the availability of Rule 4.7 to them.

### III. Proposed Substantive Revisions: Section-by-Section Analysis

As stated above, paragraph (a) would contain all of the definitions employed in Rule 4.7. To assist CPOs and CTAs in their reading of this paragraph, the introductory text of this paragraph would explain that paragraph (a)(1) contains general definitions, paragraph (a)(2) defines the term "qualified eligible participant" and paragraph (a)(3) defines the term "qualified eligible client." The proposed introductory text also would make clear, as existing introductory text now does, that these definitions are "for the purposes of this section," *i.e.*, for the purposes of Rule 4.7 only.

#### A. General Definitions: Proposed Paragraphs (a)(1)(i) Through (vi)

Proposed paragraph (a)(1) would contain general definitions, *i.e.*, those other than the QEP and QEC definitions, which would be set forth alphabetically. Certain of the rules in this paragraph, those defining "exempt account" and "exempt pool,"<sup>30</sup> would be taken intact from existing text,<sup>31</sup> as would the rule

<sup>27</sup> Existing paragraphs (b)(2), (b)(3) and (b)(4) would be redesignated as paragraphs (c) and (c)(1), (c)(2) and (c)(3), respectively, also with conforming references.

<sup>28</sup> The text of proposed paragraph (d) similarly contains conforming references.

<sup>29</sup> The term "Portfolio Requirement," which is not separately defined in existing Rule 4.7, would be defined in proposed paragraphs (a)(1)(v)(A) for QEPs and (a)(1)(v)(B) for QECs. See *infra* at Part III.A. These definitions would be taken from existing text.

<sup>30</sup> Proposed Paragraphs (a)(1)(ii) and (a)(1)(iii), respectively.

<sup>31</sup> Existing paragraphs (b)(1)(i) and (a)(1)(i), respectively.

defining "United States."<sup>32</sup> Other rules in this paragraph also would be taken from existing text, but they would have certain technical, non-substantive revisions made to them. These rules would define the terms "Non-United States person"<sup>33</sup> and "Portfolio Requirement."<sup>34</sup>

The term "Portfolio Requirement" would be set forth in two parts and would be taken intact from existing text, except that the introductory text would contain certain technical revisions necessary as a result of the proposed reorganization of Rule 4.7. The first part, (A), would pertain to QEPs and the second part, (B), would pertain to QECs. The need for, in effect, two separate definitions of "Portfolio Requirement" is due to differences in activities between the two categories of registrants for whom Rule 4.7 provides relief: CPOs operate pools and sell participations therein, whereas CTAs provide advice and open trading accounts for clients. In proposing the portfolio requirement, the Commission explained that using the "accredited investor" definition in Rule 501 under the Securities Act of 1933 ("Securities Act"), 17 CFR 230.501 (1999), as a foundation, the Commission intended to define categories of QEPs and QECs based upon objective indicia that persons—

possess either the investment expertise and experience necessary to understand the risks involved, as evidenced by the registered status of certain investment professionals [discussed at Part III.B.2.a, *infra*, who need not satisfy the portfolio requirement to be defined as a QEP or a QEC] or have an investment portfolio of a size sufficient to indicate that the [person] has substantial investment experience and thus a high degree of sophistication with regard to investments as well as financial resources to withstand the risks of their investments.<sup>35</sup>

The remaining provision in this paragraph would be entirely new. It would be the definition of the term "affiliate" of a specified person or a person "affiliated" with the specified person.<sup>36</sup> This definition is being

<sup>32</sup> Proposed Paragraph (a)(1)(vi), which would be taken from existing paragraph (a)(1)(ii)(C).

<sup>33</sup> Proposed paragraph (a)(1)(iv). Existing paragraph (a)(1)(ii)(C) defines as a QEP "a person that is not a United States person" and lists those persons who are not considered to be "United States persons."

<sup>34</sup> Proposed paragraph (a)(1)(v). The portfolio requirements for QEPs and QECs currently are set forth in existing paragraphs (a)(1)(ii)(B)(1)(i) through (iii) and (b)(1)(ii)(B)(1)(i) through (iii), respectively.

<sup>35</sup> 51 FR at 3151–52.

<sup>36</sup> Proposed paragraph (a)(1)(i). As discussed *infra* at Part III.B.2.e., the Proposal would provide that certain affiliates of CPOs and CTAs are QEPs and QECs, respectively. See, *e.g.*, CFTC Staff Letter No. 98–35 [1996–1998 Transfer Binder], Comm. Fut. L.

proposed in furtherance of the Commission's goals of providing relief under Rule 4.7 to appropriate persons and of harmonizing its rules with those of the SEC. Specifically, the Commission is proposing that for the purposes of Rule 4.7, an "affiliate" or a person "affiliated" with a specified person means "a person that directly or indirectly through one or more persons, controls, is controlled by, or is under common control with the specified person."<sup>37</sup> The proposed definition is based upon the "affiliate" definition in Rule 501 of Regulation D under the Securities Act of 1933 ("Securities Act")<sup>38</sup> and the "affiliated person" definition in Section 2(a)(3)(C) of the ICA.<sup>39</sup> As stated above, when it adopted Rule 4.7 the Commission used the "accredited investor" definition in Rule 501 under Regulation D as a foundation for determining the persons who would come within the QEP and QEC definitions. As also stated above, the Commission is now proposing amendments to the QEP and QEC definitions based upon, among other things, certain amendments to the ICA. Accordingly, the Commission believes that these two sources provide appropriate criteria for the purposes of this rule proposal.<sup>40</sup>

#### B. Persons Who Are QEPs and QECs Irrespective of the Portfolio Requirement: Proposed Paragraphs (a)(2)(i)(A) Through (L) for CPOs and (a)(3)(i)(A) Through (F) for CTAs

##### 1. Summary Overview of the Proposed Revisions

Proposed paragraphs (a)(2)(i) and (a)(3)(i) would include in the QEP and QEC definitions, respectively, persons who qualify as QEPs and QECs irrespective of whether they satisfy the Portfolio Requirement. Some of these definitions would be based upon

Rep. (CCH) ¶ 27,329 (May 12, 1998) (CPO permitted to treat as QEPs the employees of its affiliate); CFTC Staff Letter No. 98–10, [1996–1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,261 (Feb. 5, 1998) (CPO permitted to treat as QEPs the principals of an affiliate of the CPO).

<sup>37</sup> See, *e.g.*, CFTC Staff Letter No. 98–10 at 46,144, n.2 (CPO and its affiliate were related by common ownership in that they were both owned by the same persons).

<sup>38</sup> 17 CFR 230.501(b) (1999).

<sup>39</sup> 15 USC 80a–2(a)(3)(C) (1994). See also *infra* at Part III.B.2.d for the text of the definition of the term "affiliated person."

<sup>40</sup> In making this proposal, the Commission considered the alternative criteria included in the definition of "affiliated person" in the ICA, *i.e.*, in Sections 2(a)(3)(A), (B), (D) and (E), and in particular, criteria such as percentage of ownership. It decided that for the purposes of Rule 4.7, "control" is a better gauge of affiliation and further, that an arbitrary ownership threshold might be too restrictive for the purposes of the rule.

existing text and others would be entirely new. The introductory text that would apply to these definitions would be taken from existing text.<sup>41</sup>

With respect to QEPs in particular, the Proposal would retain the four classes of investment professionals currently defined as QEPs, and it also would include their principals as QEPs.<sup>42</sup> Entirely new rules would include in the QEP definition such persons as investment advisers, qualified purchasers, knowledgeable employees, certain other employees, family members of persons involved with the pool, certain trusts, and certain organizations within the meaning of Section 501(c)(3) of the Internal Revenue Code ("Section 501(c)(3) Organizations").<sup>43</sup>

Other rules, which would include in the QEP definition Non-United States persons and entities in which all of the unit owners or participants are QEPs, would be based upon existing text. Currently, the requirement that these persons be QEPs for a CPO to claim relief under Rule 4.7 is not qualified by a "who the commodity pool operator reasonably believes" standard.<sup>44</sup> Due to the proposed reorganization of Rule 4.7, however, a CPO who seeks to treat any of these persons as QEPs would have to

<sup>41</sup> Because of the proposed reorganization of Rule 4.7, the introductory text of existing paragraphs (a)(1)(ii)(A) and (b)(1)(ii)(A) would be set forth in proposed paragraphs (a)(2)(i) and (a)(3)(i), respectively.

<sup>42</sup> To make clear that the existing eligibility criteria of registration and two years' activity are alternate to and independent of the assets under management criterion, proposed paragraphs (a)(2)(i)(C) and (D) each present these criteria as (1) and (2). The Commission also is proposing to add a reference to Section 4m of the Act in these paragraphs to clarify the registration qualifications of CPOs and CTAs.

<sup>43</sup> 26 U.S.C. 501(c)(3)(1994) provides an exemption from federal income taxation for the following persons:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided \* \* \*), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Currently, the rule provides that Section 501(c)(3) Organizations qualify as QEPs if they satisfy the Portfolio Requirement (existing paragraph (a)(1)(ii)(B)(2)(vii)). This would be retained, but redesignated (proposed paragraph (a)(2)(ii)(G)). See *infra* at Part III.B.2.h.

<sup>44</sup> See existing paragraph (a)(1)(ii)(A).

reasonably believe that the person is a Non-United States person or that it is an entity comprised of QEPs. The Commission does not believe that this proposed revision should impose any additional burdens on CPOs, because it is a sound business practice that they likely have been following, notwithstanding the absence of an explicit requirement in existing text. Nonetheless, the Commission specifically requests comment on this proposed revision.

As for QECs, the text of the Proposal similarly would be taken from the current text of Rule 4.7<sup>45</sup> and would continue to incorporate by reference persons who qualify as QEPs irrespective of whether they satisfy the Portfolio Requirement. Because of the proposed addition of several persons who would qualify as QEPs irrespective of the Portfolio Requirement and because the rationale for providing relief to CTAs is analogous to that for CPOs, the Commission is proposing generally to include as QECs the same persons it is proposing to include as QEPs. Entirely new rules also would include in the QEC definition such persons as certain employees of the CTA, family members of those employees, and certain trusts. As with CPOs, due to the proposed reorganization of Rule 4.7, CTAs who seek to qualify such persons as QECs would have to reasonably believe that these persons meet the QEC criteria. Here too, and for the reasons provided above with respect to CPOs, the Commission does not believe that this proposed revision should impose any additional burdens on CTAs.

## 2. The Proposed Revisions

### a. Principals of Certain Registered Investment Professionals—Proposed Paragraphs (a)(2)(i)(A) Through (D) and (a)(3)(i)(A)

Rule 4.7 would continue to include in the QEP and QEC definitions the four classes of registered investment professionals specified in the existing rule,<sup>46</sup> and it would be amended to include the principals of such persons. For the purposes of Part 4, the term "principal" is defined in Rule 4.10(e) to mean:

(i) Any person including, but not limited to, a sole proprietor, general partner, officer or director, or person occupying a similar status or performing similar functions, having the power, directly or indirectly, through agreement or otherwise, to exercise a controlling influence over the activities of the entity;

<sup>45</sup> As discussed above, however, the introductory text would be redesignated as paragraph (a)(3)(i).

<sup>46</sup> Existing paragraphs (a)(1)(ii)(A)(1) through (4).

(ii) Any holder or any beneficial owner of ten percent or more of the outstanding shares of any class of stock of the entity; and

(iii) Any person who has contributed ten percent or more of the capital of the entity.

When it proposed Rule 4.7, the Commission noted that these registered investment professionals "may be presumed to have sufficient expertise to evaluate the risks and benefits of investing in a commodity pool."<sup>47</sup> Commission staff's experience has been that most of the persons comprising the classes of investment professionals listed in Rules 4.7(a) and 4.7(b) have principals, inasmuch as these persons typically are not natural persons. Commission staff further has found that it is mainly the principals of these investment professionals, and not the investment professionals themselves, who seek to participate in an exempt pool or open an exempt account.<sup>48</sup> Accordingly, the Commission is proposing to include the principals of these investment professionals as QEPs and QECs.

### b. Registered Investment Advisers and Their Principals—Proposed Paragraphs (a)(2)(i)(E) and (a)(3)(i)(A)

As stated above, the Commission included the investment professionals specified in existing Rule 4.7 as QEPs and QECs because they "may be presumed to have sufficient expertise to evaluate the risks and benefits of investing in a commodity pool" (or opening a managed account). Upon consideration, the Commission believes that certain investment advisers also may be presumed to have such expertise as to come within the purpose of the QEP and QEC definitions and that, for the reasons provided above with respect to the Commission's proposal to include as QEPs and QECs the principals of the investment professionals defined as QEPs and QECs,<sup>49</sup> the principals of these investment advisers also should be included in the QEP and QEC definitions.<sup>50</sup>

<sup>47</sup> 57 FR at 3152.

<sup>48</sup> See, e.g., CFTC Staff Letter No. 98-65, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,413 (Aug. 24, 1998) (two CPOs permitted to treat as QEPs the principals of the CPOs); CFTC Staff Letter No. 96-36 [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,686 (May 2, 1996) (CPO permitted to treat as a QEP a vice president of the CPO who was the managing director and principal of a broker-dealer subsidiary of the CPO).

<sup>49</sup> See *supra* at Part III.B.2.a.

<sup>50</sup> See, e.g., CFTC Staff Letter No. 94-63, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,152 (March 24, 1994) (CPO permitted to treat the principal of an investment adviser as a QEP). These proposed changes, and the proposed inclusion as QEPs and QECs of, among other persons, qualified purchasers and knowledgeable

Specifically, these new rules would provide that, to be a QEP or a QEC, an investment adviser must be registered as an investment adviser under Section 203 of the Investment Advisers Act of 1940 ("IAA")<sup>51</sup> or pursuant to the laws of any state. Additionally, the investment adviser: (1) Must have been registered and active as such for two years; or (2) must provide securities investment advice to securities accounts which, in the aggregate, have total assets in excess of \$5 million on deposit with one or more registered securities brokers. These criteria would be consistent with the current criteria applicable to investment professionals in general<sup>52</sup> and CTAs in particular.<sup>53</sup>

#### c. Qualified Purchasers—Proposed Paragraphs (a)(2)(i)(F) and (a)(3)(i)(A)

As previously stated, NSMIA added Section 3(c)(7) to the ICA, which provides an exemption from the definition of the term "investment company" to issuers whose securities are held exclusively<sup>54</sup> by persons who come within the definition of the term "qualified purchaser" set forth in Section 2(a)(51)(A)<sup>55</sup> of the ICA. This section defines a QP as:

- (i) any natural person (including any person who holds a joint, community property, or other similar shared ownership interest in an issuer that is excepted under section 80a-3(c)(7) of this title with that person's qualified purchaser spouse) who owns not less than \$5,000,000 in investments, as defined by the Commission;
- (ii) any company that owns not less than \$5,000,000 in investments and that is owned directly or indirectly by or for 2 or more natural persons who are related as siblings or spouse (including former spouses), or direct lineal descendants by birth or adoption, spouses of such persons, the estates of such persons, or foundations, charitable organizations, or trusts established by or for the benefit of such persons;
- (iii) any trust that is not covered by clause (ii) and that was not formed for the specific purpose of acquiring the securities offered, as to which the trustee or other person authorized to make decisions with respect to the trust, and each settlor or other person

employees, would cause existing paragraph (a)(1)(ii)(A)(5) to be redesignated as paragraph (a)(2)(i)(H)(1) and paragraph (a)(3)(i)(A) to refer to "[a] person described in paragraph (a)(2)(i)(A), (B), (C), (D), (E), (F), (G), (J) or (K) of this section."

<sup>51</sup> 15 U.S.C. 80b-3 (1994 & Supp. III 1997).

<sup>52</sup> For example, brokers or dealers who are registered pursuant to section 15 of the Securities Exchange Act of 1934 are defined as QEPs and QECs under existing paragraphs (a)(1)(ii)(A)(2) and (b)(1)(ii)(A), respectively.

<sup>53</sup> See existing paragraphs (a)(1)(ii)(A)(4) and (b)(1)(ii)(A).

<sup>54</sup> But see *supra* at Part I.C. (knowledgeable employees may acquire the securities of Section 3(c)(7) and 3(c)(1) funds).

<sup>55</sup> 15 U.S.C. 80a-2(a)(51)(A) (Supp. III 1997).

who has contributed assets to the trust, is a person described in clause (i), (ii) or (iv); or

(iv) any person, acting for its own account or the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis, not less than \$25,000,000 in investments.

Section 3(c)(7) was added to the ICA for the purposes of eliminating certain regulatory impediments for private investment pools, such as hedge funds and venture capital firms raising capital for new and growing businesses.<sup>56</sup>

The Commission is proposing to include QPs in the QEP and QEC definitions for two reasons. First, the Commission believes that persons defined as QPs, like those currently defined as QEPs and QECs, are sophisticated investors who have the financial ability and experience necessary to understand the risks of commodity interest trading and to obtain the information they require. Second, treating QPs as QEPs would further the Commission's objective in proposing Rule 4.7 to coordinate its rules with those of the SEC applicable to private offerings exempt from registration under the Securities Act.<sup>57</sup>

#### d. Knowledgeable Employees—Proposed Paragraphs (a)(2)(i)(G) and (a)(3)(i)(A)

As also previously stated, NSMIA directed the SEC to promulgate rules that would permit the ownership by knowledgeable employees of the securities of an issuer (or an affiliated person of the issuer) without loss of the issuer's exemption from the investment company definition under Section 3(c)(1) or 3(c)(7) of the ICA. In 1997, the SEC adopted Rule 3c-5 under the ICA, which defines the term "knowledgeable employee" as a natural person who is:

- (i) An Executive Officer,<sup>58</sup> director, trustee, general partner, advisory board member, or person serving in a similar capacity, of the Covered Company<sup>59</sup> or an Affiliated Management Person<sup>60</sup> of the Covered Company; or

<sup>56</sup> H.R. Rep. No. 622, 104th Cong., 2d Sess., at 16 (1996), reprinted in 1996 U.S.C.C.A.N. 3877.

<sup>57</sup> A private placement under the Securities Act is a prerequisite to eligibility under Sections 3(c)(1) and 3(c)(7) of the ICA.

<sup>58</sup> Rule 3c-5(a)(3) further defines an "Executive Officer" as "the president, any vice president in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions, for a covered Company or for an Affiliated Management Person of the Covered Company."

<sup>59</sup> Rule 3c-5(a)(2) defines a "Covered Company" as a Section 3(c)(1) Company or a Section 3(c)(7) Company.

<sup>60</sup> Rule 3c-5(ak)(1) defines an "Affiliated Management Person" of the Covered Company as an "an affiliated person, as such term is defined in

(ii) An employee of the Covered Company or an Affiliated Management Person of the Covered Company (other than an employee performing solely clerical, secretarial or administrative functions with regard to such company or its investments) who, in connection with his or her regular functions or duties, participates in the investment activities of such Covered Company, other Covered Companies, or investment companies the investment activities of which are managed by such Affiliated Management Person of the Covered Company, provided that such employee has been performing such functions and duties for or on behalf of the Covered Company or the Affiliated Management Person of the Covered Company, or substantially similar functions or duties for or on behalf of another company for at least 12 months.

In furtherance of the Commission's goal of providing relief under Rule 4.7 to appropriate persons and of harmonizing its rules with those of the SEC, the Commission is proposing to include knowledgeable employees in the QEP and QEC definitions.

In this regard, the Commission notes that in April of 1999, staff of the SEC's Division of Investment Management responded to a series of inquiries from the Subcommittee on Private Investment Entities of the Federal Regulation of Securities Committee, Section of Business Law of the American Bar Association ("ABA") concerning the scope of both the QP and knowledgeable employee definitions.<sup>61</sup> With respect to knowledgeable employees in particular, SEC staff, among other things, clarified the criterion that a knowledgeable employee "participate in investment activities." In particular, SEC staff stated that "[t]he rule \* \* \* is clearly intended to encompass persons who actively participate in the management of a Fund's investments. The rule is not intended to include employees who

section 2(a)(3) of the Act [15 USC 80a-2(a)(3)], that manages the investment activities of a Covered Company." Section 2(a)(3) of the ICA, 15 U.S.C. 80a-2(a)(3)(1994), defines an "affiliated person" of another person as:

- (A) Any person directly or indirectly owning, controlling, or holding with power to vote 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by or under common control with, such other person. (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof.

Rule 3c-5(a)(1) further provides that "[f]or purposes of this definition, the term 'investment company' as used in section 2(a)(3) of the Act includes a Covered Company."

<sup>61</sup> American Bar Ass'n, [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 7,548 (April 22, 1999) (the "ABA Letter").

merely obtain information regarding the investment activities of these Funds.”<sup>62</sup> SEC staff further stated that the following types of employees described in the ABA Letter generally would not qualify as knowledgeable employees within the meaning of the rule: marketing and investor relations professionals; attorneys who participate in preparing offering documents and negotiating related agreements, and who provide advice concerning ongoing fund investments, operation and compliance matters; registered brokers and traders for a related broker-dealer; and financial, compliance, operational and accounting officers who have management responsibilities. As for research analysts, SEC staff stated that, as a general matter, unless the research analyst “researches all potential portfolio investments and provides recommendations to the portfolio manager,” the analyst would not qualify as a knowledgeable employee.

Further with respect to knowledgeable employees, in adopting Rule 3c-5 under the ICA the SEC clarified the criterion that a knowledgeable employee must have been performing the requisite functions or duties “for at least 12 months.” The SEC stated:

The rule, as proposed, would have required employees who are knowledgeable employees by virtue of their participation in investment activities to have been engaged in these activities on behalf of the fund or the Management Affiliate for a period of at least 12 months. Several commenters suggested that the 12-month period would unnecessarily limit the ability of new employees who had equivalent experience with their previous employer to invest in the fund. The Commission has concluded that it is not necessary to require that an employee work for the particular fund or Management Affiliate for the entire 12-month period as long as the employee has the requisite experience to appreciate the risks of investing in the fund. The rule, as adopted, therefore includes as knowledgeable employees those employees who performed substantially similar functions or duties for or on behalf of another person during the preceding 12 months.<sup>63</sup>

The Commission intends to follow interpretations issued by the SEC and its staff of the QP and knowledgeable employee definitions.<sup>64</sup> The

Commission has the right further to interpret or to amend Rule 4.7 to exclude from the QEP and QEC definitions any person that the SEC or its staff found to be a QP or knowledgeable employee or to include in the QEP and QEC definitions any person the SEC or its staff excluded from the QP or knowledgeable employee definition, if such action is found to be necessary to effectuate the purposes of the Act and the Commission’s regulations. The Commission expects that it would exercise this right infrequently.

e. The CPO, CTA and Investment Adviser of the Exempt Pool and Their Affiliates; Affiliates of the CTA of the Exempt Account—Proposed Paragraphs (a)(2)(i)(H)(1) and (a)(3)(i)(B)(1)

Rule 4.7 currently defines as a QEP the CPO or the CTA of “the exempt pool offered or sold.”<sup>65</sup> The Proposal would incorporate this text and it also would include in the QEP definition an investment adviser of the exempt pool and an affiliate of the CPO, CTA or investment adviser.<sup>66</sup>

When it included CTAs of exempt pools in the QEC definition the Commission explained that:

[s]ince CTAs as well as CPOs may take an interest in a pool being offered, absent [inclusion of CTAs in the QEP definition], this may result in the pool losing its qualified status as a CTA client by virtue of such participation. The inclusion of this provision avoids the discrepancy that would otherwise exist.<sup>67</sup>

Commission staff has found that Rule 4.7(a) exempt pools typically trade both commodity interests and securities, and thus may have CPOs, CTAs and securities investment advisers associated with them. Since the investment adviser and affiliates of the CTA, CPO and investment adviser likewise may take an interest in the pool, the Commission is proposing to include each of these persons in the QEP definition.

An affiliate of a CTA similarly may have an account traded by the CTA. Accordingly, the Commission also is proposing to include in the QEC definition an affiliate of the CTA of the exempt account.

f. Principals, Employees and Family Members—Proposed Paragraphs (a)(2)(i)(H)(2) through (5) and (a)(3)(i)(B)(2) through (5)

The Proposal would include in the QEP and QEC definitions persons such

respectively, to make a factual determination, *i.e.*, to “reasonably believe” that a person does in fact satisfy the requisite QEP or QEC criteria.

<sup>65</sup> Existing paragraph (a)(1)(ii)(A)(5).

<sup>66</sup> The term “affiliate” is discussed *supra* at Part III.A.

<sup>67</sup> 57 FR at 34855.

as the principals and employees of CPOs and CTAs, along with certain of their family members. Each of these proposed rules is discussed separately below. Preliminarily, however, it should be noted that because certain of these rules<sup>68</sup> would be based upon the “knowledgeable employee” definition, the “12 months” and “24 months” referred to therein would refer to the preceding 12 months and 24 months, as the case may be. Thus, an employee would be a QEP or QEC under these rules if it has worked the requisite time period for a relevant employer, discussed below—who need not be the CPO or CTA seeking to treat the employee as a QEP or QEC.

i. Principals—Proposed Paragraphs (a)(2)(i)(H)(2) and (a)(3)(i)(B)(2)

The Proposal would include in the QEP definition a principal of the exempt pool, the CPO, the CTA or the investment adviser of the exempt pool, or a principal of an affiliate of the pool, CPO, CTA or investment adviser.<sup>69</sup> It similarly would include in the QEC definition a principal of the CTA of the exempt account or of an affiliate of the CTA.<sup>70</sup> These rules would be parallel to, and would be based upon the same rationale underlying, the rules to include in the QEP and QEC definitions the principals of those persons comprising the classes of investment professionals who currently are, and under the Proposal would continue to be, QEPs and QECs.<sup>71</sup>

ii. Employees Involved in Investment Management Activities—Proposed Paragraphs (a)(2)(i)(H)(3) and (a)(3)(i)(B)(3)

The Proposal would include in the QEP definition an employee of the exempt pool, the CPO, the CTA or the investment adviser of the exempt pool, or of an affiliate of the pool, CPO, CTA or investment adviser, provided that the employee: (1) In connection with his or her regular functions or duties participates in the investment activities of the exempt pool or other commodity pools operated by the CPO of the exempt pool or other accounts advised by the CTA or the investment adviser of the exempt pool, or by an affiliate; and (2) has been performing such functions

<sup>68</sup> Proposed paragraphs (a)(2)(i)(H)(3) and (4) and (a)(3)(i)(B)(3) and (4).

<sup>69</sup> Because many collective investment vehicles trade both commodity interests and securities, and they would have both CTAs and investment advisers providing trading advice to them.

<sup>70</sup> See *supra* at Part III.B.2.a. for a discussion of the term “principal.”

<sup>71</sup> See, *e.g.*, CFTC Staff Letter No. 98–69, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,438 (Sept. 24, 1998) (CPO permitted to treat as QEPs the principals of the CPO).

<sup>62</sup> ABA Letter at 78,746 (footnote omitted).

<sup>63</sup> 62 FR at 17524–25.

<sup>64</sup> In this regard, however, SEC staff has stated that whether an employee “actively participates in the investment activities of a Fund is a factual determination that must be made on a case-by-case basis by the Fund,” and that consequently, SEC staff generally will not entertain any requests on its views “with respect to whether a particular employee or type of employee meets this aspect of the knowledgeable employee definition.” ABA Letter at 78,746.

Proposed Paragraphs (a)(2)(i) and (a)(3)(i), which are based on existing paragraphs (a)(1)(i)(A) and (b)(1)(ii)(A), similarly require CPOs and CTAs,

or duties for the employer, or substantially similar functions or duties for another person engaged in providing commodity interest, securities or other financial services, for at least 12 months. This rule specifically would exclude employees who perform solely clerical, secretarial or administrative functions.

In proposing this rule, the Commission is seeking to harmonize its rules with those of the SEC. Thus, the employee that would qualify under this rule must, for example, "actively participate" in the management of the pool's investments. The rule would not include as QEPs employees such as financial, compliance and operational professionals, brokers, traders, or attorneys who merely obtain information regarding the investments, nor would it include research analysts, unless such persons research all potential investments for the pool and provide their recommendations to the person who makes the investment decisions for the pool. The foregoing is intended to ensure that if the employee of a person specified under the rule would qualify as a knowledgeable employee but for the fact that the employee is an employee of a commodity pool, its operator, advisor or affiliate and is not an employee of a Covered Company or an Affiliated Management Person, then the employee may be considered a QEP.

Similarly, the Proposal would include in the QEC definition an employee of the CTA of the exempt account or of an affiliate of the CTA provided that the employee: (1) In connection with his or her regular functions and duties participates in the management of the investment activities of the CTA or the affiliate; and (2) has been performing such functions and duties for the employer or substantially similar functions or duties for another person engaged in providing commodity interest, securities or other financial services for at least 12 months.<sup>72</sup> Here, too, the rule specifically would exclude employees who perform solely clerical, secretarial or administrative functions. The Commission intends that this rule would be applicable under the same

<sup>72</sup> The courts generally have held that an account that trades solely commodity interests is not a "security" within the meaning of the federal securities laws. See, e.g., *Salcer v. Merrill Lynch, Pierce, Fenner and Smith Inc.*, 682 F.2d 459 (3d Cir. 1982); *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96 (7th Cir. 1977). Accordingly, such an account would not have an investment adviser. For this reason, proposed paragraphs (a)(3)(i)(B)(1) through (5) do not refer to an investment adviser of the exempt account (or to a principal, affiliate or employee of an investment adviser of the exempt account).

types of situations as discussed above with respect to certain employees as QEPs and thus, an employee who merely obtains information about the investment activities of a CTA or an affiliate, but does not "actively participate" in such investment activities, would not qualify as a QEC under this rule.<sup>73</sup>

iii. Other Employees-Proposed Paragraphs (a)(2)(i)(H)(4) and (a)(3)(i)(B)(4)

The Proposal also would include in the QEP definition any other employee of the exempt pool, CPO, CTA or investment adviser of the exempt pool, or of an affiliate of the pool, CPO, CTA or investment adviser, provided the employee: (1) Is an accredited investor as defined in Rule 501(a)(5)<sup>74</sup> or 501(a)(6)<sup>75</sup> under the Securities Act ("Accredited Investor"); and (2) has been employed by such person, or by another person engaged in providing commodity interest, securities or other financial services, for at least 24 months. Employees who perform solely clerical, secretarial or administrative functions would be expressly excluded from this rule. Thus, the financial, compliance and operational professionals, brokers, traders and attorneys who would not qualify as QEPs because they do not "actively participate" in investment management activities would qualify as QEPs under this rule if they are Accredited Investors and have two years of relevant experience. A research analyst responsible for performing research with respect to one commodity or one market also would qualify under this provision, if the employee otherwise meets the requirements of the proposed rule, *i.e.*, that he or she has two years of relevant experience and is an Accredited Investor.

<sup>73</sup> Here, too, the Commission intends that a determination of whether an employee is a QEP or a QEC under proposed paragraph (a)(2)(i)(H)(3) or (a)(3)(i)(B)(3), respectively, would be made on a case-by-case basis by the CPO of the exempt pool or the CTA of the exempt account-based on the "reasonably believes" standard set forth in proposed paragraphs (a)(2)(i) and (a)(3)(i), respectively.

<sup>74</sup> Rule 501(a)(5) under the Securities Act defines an accredited investor as:

Any natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase [of securities exempt from registration under the Securities Act] exceeds \$1,000,000.

<sup>75</sup> Rule 501(a)(6) under the Securities Act defines an accredited investor as:

Any natural person who had an individual income in excess of \$200,000 in each of the two most recent years or joint income with that person's spouse in excess of \$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year.

Similarly, the Proposal would include in the QEC definition any other employee of the CTA of the exempt account or of an affiliate of the CTA (other than employees performing solely clerical, secretarial or administrative functions), provided that the employee: (1) Is an Accredited Investor; and (2) has been employed by such person, or by another person engaged in providing commodity interest, securities or other financial services, for at least 24 months.

The Commission is proposing these new rules because it believes that defining as QEPs and QECs persons who satisfy the foregoing criteria would be consistent with the intent of Rule 4.7 of reducing unnecessary regulatory prescriptions for CPOs and CTAs with respect to persons who do not appear to need the full protections offered by the Part 4 framework.<sup>76</sup>

iv. Family Members—Proposed Paragraphs (a)(2)(i)(H)(5) and (a)(3)(i)(B)(5)

The Proposal further would include in the QEP definition the spouse, child, sibling or parent of a person who is associated with the exempt pool in which the family member seeks to invest,<sup>77</sup> provided that an investment in the exempt pool by any such family member is made with the knowledge and at the direction of the person. Similarly, the Proposal would include in the QEC definition the spouse, child, sibling or parent of the CTA of the exempt account or of a person who is associated with the CTA, provided that the establishment of an exempt account by any such family member is made with the knowledge and at the direction of the trading advisor or person. Given the very limited scope of these definitions, the Commission further is proposing that the family member would be a QEP or a QEC solely for the purposes of the applicable paragraph. Thus, for example, the sibling of a person who is associated with the exempt pool (*e.g.*, the person is the sole owner of the pool's CPO) would not be a QEP for the purposes of any other provision under Rule 4.7.<sup>78</sup>

<sup>76</sup> See 57 FR at 3150. See also CFTC Staff Letter No. 98-14, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,265 (Feb. 27, 1998) (CPO permitted to treat as QEPs certain employees of the CPO).

<sup>77</sup> See, e.g., CFTC Staff Letter No. 98-47, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,383 (July 22, 1998) (CPO permitted to treat as QEPs the parents of the sole owner, managing member and principal of a CPO).

<sup>78</sup> For example, the sibling would not be a QEP under proposed paragraph (a)(2)(ii)(L), which would require, among other things, that for a pool to be a QEP, the pool's participation in the exempt pool must be directed by a QEP.

g. Trusts—Proposed Paragraphs (a)(2)(i)(I) and (a)(3)(i)(C)

The Proposal would provide alternate criteria for trusts to qualify as QEPs and QECs. Rule 4.7 currently provides that trusts qualify as QEPs and QECs if, among other things, they meet a portfolio requirement and have total assets in excess of \$5 million.<sup>79</sup> In the course of administering Rule 4.7, Commission staff has become aware of situations where a trust cannot meet the existing QEP criteria for trusts, but the person who makes the investment decisions for the trust and the person who has contributed assets to the trust is a QEP. Because the decision-maker and settlor of a trust are critically integral to the trust, staff has permitted CPOs to treat trusts as QEPs in these situations.<sup>80</sup> The proposed rules would include these trusts as QEPs and QECs, provided they were not formed for the purpose of participating in an exempt pool or opening an exempt account.

These proposed rules are modeled after Section 2(a)(51)(A)(iii) of the ICA, which, as stated above, defines as QPs trusts that meet similar criteria, except that a trust qualifies as a QP under Section 2(a)(51)(A)(iii) if it was not formed for the specific purpose of “acquiring the securities of the exempt issuer.” Neither the Act nor the Commission’s regulations, however, contain provisions directly relating to the acquisition of securities, or the “securities of an exempt issuer.” Accordingly, the Proposal would provide that trusts not formed for the specific purpose of “participating in the exempt pool” or “opening an exempt account” would be QEPs or QECs, respectively.

h. Section 501(c)(3) Organizations—Proposed Paragraphs (a)(2)(i)(J) and (a)(3)(i)(A)

The Proposal would provide alternate criteria for Section 501(c)(3) Organizations to qualify as QEPs and QECs. Rule 4.7 currently provides that such organizations qualify as QEPs and QECs if they meet a portfolio requirement and have total assets in excess of \$5,000,000.<sup>81</sup> Here, too,

<sup>79</sup> Existing paragraphs (a)(1)(ii)(B)(2)(xi) and (b)(1)(ii)(B)(2)(xi), respectively. Under proposed paragraphs (a)(2)(ii)(L) and (a)(3)(ii)(L), trusts would continue to qualify as QEPs and QECs, respectively, subject to meeting the Portfolio Requirement and certain other criteria.

<sup>80</sup> See, e.g., CFTC Staff Letter No. 98–48, [1996–1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,384 (June 22, 1998) (CPO permitted to treat a trust that was established for estate-planning purposes and had total assets of approximately \$77,000 as a QEP where the decision-maker and the settlor of the trust was himself a QEP).

<sup>81</sup> Existing paragraphs (a)(1)(ii)(B)(2)(vii) and (b)(1)(ii)(B)(2)(vii), respectively. Under proposed

Commission staff has become aware of situations where a Section 501(c)(3) Organization itself cannot meet the requisite QEP criteria, but the person who makes the investment decisions for the organization and the person who established the organization is a QEP. Because the decision-maker and person who has established the organization are critically integral to the organization, staff has permitted CPOs to treat Section 501(c)(3) Organizations as QEPs in these situations.<sup>82</sup> The proposed rules would include these organizations as QEPs and QECs.

i. Non-United States Persons as QECs—Proposed Paragraph (a)(3)(i)(A)(2)

The Proposal would include, under certain circumstances, a Non-United States person in the QEC definition.<sup>83</sup> Specifically, a Non-United States person would come within the QEC definition where the CTA who seeks to direct or guide the commodity interest trading account of the person: (1) Provides commodity interest trading advice solely to persons who are QECs (including persons who are Non-United States persons); and (2) has filed a notice of claim for exemption pursuant to proposed Rule 4.7(c).

Currently, persons who are not United States persons are QEPs,<sup>84</sup> but they are not also QECs. In adopting Rule 4.7 the Commission stated that it had defined persons who are not United States persons as QEPs with the objective of facilitating multijurisdictional offerings,<sup>85</sup> an objective that is not applicable in the context of CTAs and individual managed accounts. In this regard, the Commission noted that Rule 4.7 would provide relief to CTAs that would not be generally available to investment advisers under the securities laws and that therefore investment advisers advising QECs would be obligated to deliver a brochure to such clients. On this basis, the Commission determined not to include persons who

paragraphs (a)(2)(ii)(G) and (a)(3)(ii)(G), Section 501(c)(3) Organizations would continue to qualify as QEPs and QECs, respectively, subject to meeting the criteria of the existing rules.

<sup>82</sup> See e.g., CFTC Staff Letter No. 97–16, [1996–1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,008 (March 21, 1997) (CPO permitted to treat a Section 501(c)(3) charitable organization as a QEP where the investment decisions were made by an individual who was a QEP and that individual also established the charitable organization).

<sup>83</sup> As discussed supra at Part III.A., the term “Non-United States person” would be defined in proposed paragraph (a)(1)(iv), and it would be based on the text of existing paragraph (a)(1)(ii)(C).

Proposed paragraph (a)(3)(i)(A) would include Non-United States persons as QECs through incorporation by reference to the fact that they would be QEPs under proposed paragraph (a)(2)(i)(K).

<sup>84</sup> Existing paragraph (a)(1)(ii)(C).

<sup>85</sup> See 57 FR at 34856.

were not United States persons as QECs. The Commission further stated that inclusion of these persons as QECs without regard to qualifying criteria should await further experience with the QEC concept.<sup>86</sup>

Currently, then, a CTA is ineligible for relief under Rule 4.7 with respect to those of its advisory clients who are Non-United States persons (and who are not otherwise QECs). In the past, Commission staff has provided exemptive relief from the specific Disclosure Document requirements of Rules 4.31, 4.34, 4.35 and 4.36 where a CTA directs or guides exclusively the accounts of Non-United States persons.<sup>87</sup> The Proposal would codify this practice. It also would incorporate Commission staff’s belief that where the clients for which a CTA directs or guides accounts are a mix of Non-United States persons and persons who are QECs, Rule 4.7 should be available to the CTA.

If a CTA additionally directs or guides the accounts of United States persons who are not QECs, however, under the Proposal, Rule 4.7 relief would remain unavailable to the CTA with respect to its clients who are Non-United States persons. This is because in such case (*i.e.*, where the CTA directs or guides the accounts of persons who are QECs and persons who are not QECs), the CTA is subject to the Disclosure Document requirements of Rules 4.31, 4.34, 4.35 and 4.36 and the recordkeeping requirements of Rule 4.33 with respect to its clients who are not QECs. Requiring the CTA also to comply with these Disclosure Document and recordkeeping requirements with respect to its clients who are Non-United States persons should not impose any additional burden on the CTA, since these are requirements with which it already is subject to compliance.

The Commission believes that the limitations of the proposed rule are consistent both with prior staff practice and the purposes of Rule 4.7. The Commission nonetheless specifically requests comments on this proposed rule.

*C. Persons Who Must Satisfy the Portfolio Requirement To Be QEPs and QECs—Proposed Paragraphs (a)(2)(ii)(A) Through (L) and (a)(3)(ii)(A) and (L)*

The text of this portion of the Proposal would be based upon existing

<sup>86</sup> See *Id.* at n.21.

<sup>87</sup> See, e.g., CFTC Staff Letter No. 97–09, [1996–1998 Transfer Binder] Comm. Fut. L. Rep. ¶ 26, 976 (Feb. 6, 1997); CFTC Staff Letter No. 95–73, [1994–1996 Transfer Binder] Comm. Fut. L. Rep. ¶ 26, 503 (Aug. 24, 1995).

text, and it would continue to include in the QEP and QEC definitions those persons who must satisfy a portfolio requirement<sup>88</sup> in order to qualify as QEPs or QECs.

With respect to QEPs in particular, all but one of the proposed rules<sup>89</sup> would be taken from existing text,<sup>90</sup> with various technical revisions made to them.<sup>91</sup> The remaining proposed rule would be taken from existing text but would be amended, as discussed below, to make it easier for pools, trusts, insurance company separate accounts and bank collective trusts to qualify as QEPs.

With respect to these collective investment vehicles, Rule 4.7 currently provides that a QEP is:

A pool, trust, insurance company separate account or bank collective trust, with total assets in excess of \$5,000,000, not formed for the specific purpose of participating in the exempt pool, and whose participation in the exempt pool is directed by a qualified eligible participant; Provided, That except where the pool, trust, insurance company separate account or bank collective trust would constitute a qualified eligible participant under paragraph (a)(1)(ii)(D) of this section, no more than 10 percent of the

fair market value of the assets of such entity are used to purchase units in exempt pools.<sup>92</sup> The foregoing proviso is sometimes referred to as the "Ten Percent Restriction." The Commission stated that it proposed this restriction "because participants in these entities may not be QEPs and thus could not invest in a qualified eligible pool based on their own financial qualifications and investment sophistication."<sup>93</sup> Based upon staff's experience with the Ten Percent Restriction, the Commission has come to the view that the other criteria of the rule—*i.e.* that the collective investment vehicle must satisfy a portfolio requirement, must have total assets in excess of \$5 million, may not be formed for the specific purpose of participating in the exempt pool and must have its participation in the exempt pool directed by a QEP—are sufficient to satisfy the Commission's concerns.<sup>94</sup> Accordingly, the Commission is proposing to eliminate the Ten Percent Restriction.<sup>95</sup>

As for QECs, the Proposal would continue to include in the QEC definition those persons who, subject to satisfying a portfolio requirement, would be QECs.<sup>96</sup> The Proposal also

would continue to include certain trusts, insurance company separate accounts and bank collective trusts in the QEC definition.<sup>97</sup> To parallel the action proposing to eliminate the Ten Percent Restriction, and for the reasons stated above in support of that action, the Commission also is proposing to eliminate the current requirement that these trading vehicles are vehicles "in which all of the unit owners or participants, other than the commodity trading advisor claiming relief under this section, are qualified eligible participants."

**IV. Comparison Chart**

The following chart compares proposed Rule 4.7 with existing Rule 4.7. For each proposed paragraph, the chart indicates the corresponding existing paragraph, with any substantive revision ("SR") or technical revision ("TR") to the existing paragraph noted. The chart also indicates by "—" any proposed paragraph that does not correspond to an existing paragraph. To avoid what otherwise would be a very lengthy presentation, as appropriate the chart groups together certain paragraphs.

Proposed rule 4.7	Existing rule 4.7	Proposed rule 4.7	Existing rule 4.7	Proposed rule 4.7	Existing rule 4.7
(a) .....	(a)(1), SR .....	(a)(2)(i)(K)–(L) .....	(a)(1)(ii)(C)–(D), SR, TR.	(b)(1)(iv) .....	(a)(2)(iv), TR
(a)(1) .....	.....	(a)(2)(ii) .....	(a)(1)(ii)(B)(1)–(2), TR	(b)(2) .....	(a)(3)
(a)(1)(i) .....	.....	(a)(2)(ii)(A) .....	(a)(1)(ii)(B)(2)(i), TR ..	(b)(2)(i) .....	(a)(3)(i)
(a)(1)(ii) .....	(b)(1)(i), TR .....	(a)(2)(ii)(B)–(D) .....	(a)(1)(ii)(B)(2)(ii)–(iv)	(b)(2)(i)(A)–(C) .....	(a)(3)(i)(A)–(C)
(a)(1)(iii) .....	(a)(1)(i), TR .....	(a)(2)(ii)(E)–(G) .....	(a)(1)(ii)(B)(2)(v)–(vii), TR.	(b)(2)(i)(D) .....	(a)(3)(i)(D), TR
(a)(1)(iv) .....	(a)(1)(ii)(C), TR .....	(a)(2)(ii)(H)–(J) .....	(a)(1)(ii)(B)(2)(viii)–(x)	(b)(2)(i)(E)–(H) .....	(a)(3)(i)(E)–(H)
(a)(1)(iv)(A)–(C) .....	(a)(1)(ii)(C)(1)–(3) .....	(a)(2)(ii)(K) .....	(a)(1)(ii)(B)(2)(xii), TR	(b)(2)(i)(I)(1) .....	(a)(3)(i)(I)(1), TR
(a)(1)(iv)(D) .....	(a)(1)(ii)(C)(4), TR .....	(a)(2)(ii)(L) .....	(a)(1)(ii)(B)(2)(xi), SR	(b)(2)(i)(I)(2) .....	(a)(3)(i)(I)(2), TR
(a)(1)(iv)(E) .....	(a)(1)(ii)(C)(5) .....	(a)(3) .....	(b)(1)(ii), TR .....	(b)(2)(ii)–(iii) .....	(a)(3)(ii)–(iii)
(a)(1)(v) .....	.....	(a)(3)(i) .....	(b)(1)(ii)(A), TR .....	(b)(3) .....	(a)(4)
(a)(1)(v)(A) .....	(a)(1)(iii)(B), SR, TR ..	(a)(3)(i)(A) .....	(b)(1)(ii)(A), SR, TR ..	(c) .....	(b)(2), TR
(a)(1)(v)(A)(1)–(2) .....	(a)(1)(ii)(B)(1)(i)–(ii) ..	(a)(3)(i)(B)–(C) .....	(a)(3)(i)(D) .....	(c)(1) .....	(b)(2)(i)–(ii)
(a)(1)(v)(A)(3) .....	(a)(1)(ii)(B)(1)(iii), TR	(a)(3)(i)(D) .....	(b)(1)(ii)(C), SR, TR ..	(c)(1)(i)–(ii) .....	(b)(2)(i)–(ii)
(a)(1)(v)(B) .....	(b)(1)(ii)(B), SR, TR ..	(a)(3)(i)(E) .....	(b)(1)(ii)(D), SR, TR ..	(c)(2) .....	(b)(3)
(a)(1)(v)(B)(1)–(2) .....	(b)(1)(ii)(B)(1)(i)–(ii) ..	(a)(3)(i)(F) .....	(b)(1)(ii)(E), SR, TR ..	(c)(2)(i)–(iii) .....	(b)(3)(i)–(iii)
(a)(1)(v)(B)(3) .....	(b)(1)(iii)(B)(1)(iii), TR	(a)(3)(ii)(A)–(B) .....	(b)(1)(ii)(B)(1)–(2), TR	(c)(3) .....	(b)(4)
(a)(1)(vi) .....	(a)(1)(ii)(C) .....	(a)(3)(ii)(C)–(D) .....	(b)(1)(ii)(B)(2)(iii)–(iv)	(d) .....	(c)
(a)(2) .....	(a)(1)(ii), TR .....	(a)(3)(ii)(E)–(G) .....	(b)(1)(ii)(B)(2)(v)–(vii), TR.		
(a)(2)(i) .....	(a)(1)(ii)(A), TR .....	(a)(3)(ii)(H)–(J) .....	(b)(1)(ii)(B)(2)(viii)–(x)		
(a)(2)(i)(A)–(B) .....	(a)(1)(ii)(A)(1)–(2), SR	(a)(3)(ii)(K) .....	(b)(1)(ii)(B)(2)(xii), TR		
(a)(2)(i)(C)(1)–(2) .....	(a)(1)(ii)(A)(3), TR .....				

<sup>88</sup> As discussed supra at Part III.A, the portfolio requirement would be set forth in the definitional section of the rule. See Proposed paragraph (a)(1)(v).

<sup>89</sup> Proposed paragraphs (a)(2)(ii)(A) through (K).

<sup>90</sup> See existing paragraphs (a)(1)(ii)(B)(2)(i) through (x) and (xii).

<sup>91</sup> Compare existing paragraph (a)(1)(ii)(B)(2)(i), which uses a full citation to the ICA, with proposed paragraph (a)(2)(ii)(A), which would use a short form citation to the ICA.

<sup>92</sup> Existing paragraph (a)(1)(ii)(B)(2)(xi).

<sup>93</sup> 57 FR at 3152. In light of the differences between an exempt pool, which is owned by two or more pool participants, and an exempt account, which as a non-pooled investment vehicle may only be owned by one client, existing paragraph (b)(1)(ii)(B)(2)(xi) does not contain a proviso corresponding to the Ten Percent Restriction.

<sup>94</sup> See, e.g., CFTC Staff Letter No. 98–37 [1996–1998 Transfer Binder] Comm. Fut. L. Rep. [CCH] ¶ 27,360 (June 5, 1998) (CPO granted relief from the Ten Percent Restriction with respect to a trust that was comprised of a QEP and his non-QEP wife, where the trust met the portfolio requirement, had total assets in excess of \$5 million, was not formed

for the specific purposes of participating in the exempt pool and had its participation in the exempt pool directed by a QEP).

<sup>95</sup> Proposed paragraph (a)(2)(ii)(L).

<sup>96</sup> Proposed paragraph (a)(3)(ii)(A) through (L). Thus, the Proposal would continue to include within the QEC definition those persons who are defined as QECs under existing paragraphs (b)(1)(ii)(B)(2)(i) through (x) and (xii).

<sup>97</sup> Proposed paragraph (a)(3)(ii)(L). These collective investment vehicles currently are included as QECs under existing paragraph (b)(1)(ii)(B)(2)(xi).

Proposed rule 4.7	Existing rule 4.7	Proposed rule 4.7	Existing rule 4.7	Proposed rule 4.7	Existing rule 4.7
(a)(2)(i)(D) .....	(a)(1)(ii)(A)(4), SR, TR.	(a)(3)(ii)(L) .....	(b)(1)(ii)(B)(2)(xi), SR	(d)(1) .....	(c)(1)
(a)(2)(i)(E)–(G) .....	.....			(d)(1)(i)–(iii) .....	(c)(1)(i)–(iii)
(a)(2)(i)(H)(1) .....	(a)(1)(ii)(A)(5), SR .....	(b) .....	(a)(2), TR .....		
(a)(2)(i)(H)(2)–(5) .....	.....	(b)(1) .....	.....	(d)(2) .....	(c)(2), TR
(a)(2)(i)(I)–(J) .....	.....	(b)(1)(i)–(iii) .....	(a)(2)(i)–(iii).		

**V. Related Matters**

**A. Paperwork Reduction Act**

Rule 4.7 affects information collection requirements. As required by the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)), the Commission has submitted a copy of this section to the Office of Management and Budget for its review.

**Collection of Information**

Rules Relating to the Operations and Activities of Commodity Pool Operators and Commodity Trading Advisors and to Monthly Reporting by Futures Commission Merchants, OMB Control Number 3038–0005.

The expected effect of the proposed amended rule will be to reduce the burden previously approved by OMB for this collection of information by 1,644 hours because, while it will result in an increase in the number of filings under Rule 4.7, it will result in a larger decrease in the information collection requirements under the disclosure, reporting and recordkeeping rules.

Specifically:

The burden associated with Commission Rule 4.7, as applied to CPOs and CTAs, is expected to be increased by 30 hours:

*Estimated number of respondents (after proposed exemption):* 660.

*Annual responses by each respondent:* 1.

*Estimated average hours per response:* 0.50.

*Annual reporting burden:* 330 hours.

This annual reporting burden of 330 hours represents an increase of 30 hours as a result of the proposed amendments to Rule 4.7.

The burden associated with Commission Rule 4.21, as applied to CPOs is expected to be decreased by 73.84 hours:

*Estimated number of respondents (after proposed exemption):* 565.

*Annual responses by each respondent:* 0.88.

*Estimated average hours per response:* 2.80.

*Annual reporting burden:* 1,392.16.

While the estimated burden figure of 1,392.16 for Rule 4.21 is higher than the burden figure previously reported to OMB, the Commission believes that the

previously reported burden figure was based on an incorrect figure for the number of CPOs and the burden figure should have been reported at 1,466. This annual reporting burden of 1,392.16 hours represents a decrease of 73.84 hours as a result of the proposed amendments to Rule 4.7.

The burden associated with Commission Rule 4.22(a), as applied to CPOs, is expected to be decreased by 548.63 hours:

*Estimated number of respondents (after proposed exemption):* 420.

*Annual responses by each respondent:* 4.75.

*Estimated average hours per response:* 3.85.

*Annual reporting burden:* 7,680.75.

This annual reporting burden of 7,680.75 hours represents a decrease of 548.63 hours as a result of the proposed amendments to Rule 4.7.

The burden associated with Commission Rule 4.22(c) is expected to be reduced by 270 hours:

*Estimated number of respondents (after proposed exemption):* 480.

*Annual responses by each respondent:* 1.

*Estimated average hours per response:* 9.

*Annual reporting burden:* 4,320.

This annual reporting burden of 4,320 hours represents a decrease of 270 hours as a result of the proposed amendments to Rule 4.7.

The burden associated with Commission Rule 4.23 is expected to be reduced by 1,260 hours:

*Estimated number of respondents (after proposed exemption):* 472.

*Annual responses by each respondent:* 1.

*Estimated average hours per response:* 42.

*Annual reporting burden:* 19,824

This annual reporting burden of 19,824 hours represents a decrease of 1,260 hours as a result of the proposed amendments to Rule 4.7.

The burden associated with Commission Rule 4.31 is expected to be reduced by 55.86 hours:

*Estimated number of respondents (after proposed exemption):* 620.

*Annual responses by each respondent:* 1.33.

*Estimated average hours per response:* 1.40.

*Annual reporting burden:* 1,154.44.

This annual reporting burden of 1,154.44 hours represents a decrease of 55.86 hours as a result of the proposed amendments to Rule 4.7.

The burden associated with Commission Rule 4.33 is expected to be reduced by 780 hours:

*Estimated number of respondents (after proposed exemption):* 1,970.

*Annual responses by each respondent:* 1.

*Estimated average hours per response:* 26.

*Annual reporting burden:* 51,220.

This annual reporting burden of 51,220 hours represents a decrease of 780 hours as a result of the proposed amendments to Rule 4.7.

Organizations and individuals desiring to submit comments on the information collection requirements should direct them to the Office of Information and Regulatory Affairs, OMB, Room 10235 New Executive Office Building, Washington, DC 20503; Attention: Desk Officer for the Commodity Futures Trading Commission.

The Commission considers comments by the public on this proposed collection of information in—

- Evaluating whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have a practical use;
  - Evaluating the accuracy of the Commission's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;
  - Enhancing the quality, usefulness, and clarity of the information to be collected; and
  - Minimizing the burden of collection of information on those who are to respond, including through the use of appropriate automated electronic, mechanical, or other technological collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.
- OMB is required to make a decision concerning the collection of information contained in these proposed regulations between 30 and 60 days after publication of this document in the

**Federal Register.** Therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. This does not affect the deadline for the public to comment to the Commission on the proposed regulations.

Copies of the information collection submission to OMB are available from the CFTC Clearance Officer, 1155 21st Street N.W., Washington, DC 20581, (202) 418-5160.

#### B. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA")<sup>98</sup> requires each federal agency to consider in the course of proposing substantive rules the effect of those rules on small entities. The proposed amendments to Rule 4.7 would affect registered CPOs and CTAs. The Commission previously has established certain definitions of "small entities" to be used by the Commission in evaluating the impact of its rules on such small entities in accordance with the RFA.<sup>99</sup> The Commission determined that registered CPOs are not small entities for the purposes of the RFA.<sup>100</sup> With respect to CTAs, the Commission stated that it would evaluate within the context of a particular rule proposal whether all or some affected CTAs should be considered to be small entities and, if so, that it would analyze the economic impact on them of any rule.<sup>101</sup>

Existing Rule 4.7 provides exemptive relief from the disclosure, reporting and recordkeeping requirements applicable to registered CPOs and CTAs with respect to pools and accounts owned solely by QEPs and QECs, respectively. The relief that is provided reduces rather than increases the regulatory requirements that apply to registered CPOs and CTAs. The proposed amendments to Rule 4.7 would expand this relief by bringing within the QEP and QEC definitions persons not included in the existing rules. Further, this expanded relief would be available to all registered CPOs and CTAs, regardless of size. The Commission thus believes that the proposed amendments, if adopted, would further reduce the regulatory burdens on registered CPOs and CTAs.

Accordingly, pursuant to 5 U.S.C. § 605(b), the Chairman, on behalf of the Commission, certifies that the action proposed to be taken herein will not have a significant economic impact on a substantial number of small entities.

#### List of Subjects in 17 CFR Part 4

Advertising, Commodity futures, Commodity pool operators, Commodity trading advisors, Consumer protection, Reporting and recordkeeping requirements.

In consideration of the foregoing, and pursuant to the authority contained in the Commodity Exchange Act, and in particular, sections 1a(4), 1a(5), 4b, 4l, 4m, 4n, 4o and 8a, 7 U.S.C. 1a, 6b, 6l, 6m, 6n, 6o and 12a, the Commission hereby proposes to amend Part 4 of Chapter I of Title 17 of the Code of Federal Regulations as follows:

#### PART 4—COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

1. The authority citation for part 4 continues to read as follows:

**Authority:** 7 U.S.C. 1a, 2, 4, 6b, 6c, 6l, 6m, 6n, 6o, 12a, and 23.

2. Section 4.7 is proposed to be revised to read as follows:

#### § 4.7 Exemption from certain part 4 requirements with respect to pools whose participants are limited to qualified eligible participants and with respect to commodity trading advisors' accounts for clients that are qualified eligible clients.

(a) *Definitions.* Paragraph (a)(1) of this section contains general definitions, paragraph (a)(2) of this section contains the definition of the term "qualified eligible participant" and paragraph (a)(3) of this section contains the definition of the term "qualified eligible client." For the purposes of this section:

(1) In general. (i) *Affiliate of*, or a person affiliated with, a specified person means a person that directly or indirectly through one or more persons, controls, is controlled by, or is under common control with the specified person.

(ii) *Exempt account* means the account of a qualified eligible client that is directed or guided by a commodity trading advisor pursuant to an effective claim for exemption under § 4.7.

(iii) *Exempt pool* means a pool that is operated pursuant to an effective claim for exemption under § 4.7.

(iv) *Non-United States person* means: (A) A natural person who is not a resident of the United States;

(B) A partnership, corporation or other entity, other than an entity organized principally for passive investment, organized under the laws of a foreign jurisdiction and which has its principal place of business in a foreign jurisdiction;

(C) An estate or trust, the income of which is not subject to United States income tax regardless of source;

(D) An entity organized principally for passive investment such as a pool, investment company or other similar entity; Provided, That units of participation in the entity held by persons who do not qualify as Non-United States persons represent in the aggregate less than 10% of the beneficial interest in the entity, and that such entity was not formed principally for the purpose of facilitating investment by persons who do not qualify as Non-United States persons in a pool with respect to which the operator is exempt from certain requirements of Part 4 of the Commission's regulations by virtue of its participants being Non-United States persons; and

(E) A pension plan for the employees, officers or principals of an entity organized and with its principal place of business outside the United States.

(v) *Portfolio Requirement* means:

(A) With respect to a qualified eligible participant, that the person:

(1) Owns securities (including pool participations) of issuers not affiliated with such participant and other investments with an aggregate market value of at least \$2,000,000;

(2) Has had on deposit with a futures commission merchant, for its own account at any time during the six-month period preceding the date of sale to that person of a pool participation in the exempt pool, at least \$200,000 in exchange-specified initial margin and option premiums for commodity interest transactions; or

(3) Owns a portfolio comprised of a combination of the funds or property specified in paragraphs (a)(1)(v)(A)(1) and (2) of this section in which the sum of the funds or property includable under paragraph (a)(1)(v)(A)(1), expressed as a percentage of the minimum amount required thereunder, and the amount of futures margin and option premiums includable under paragraph (a)(1)(v)(A)(2), expressed as a percentage of the minimum amount required thereunder, equals at least one hundred percent. An example of a composite portfolio acceptable under this paragraph (a)(1)(v)(A)(3) would consist of \$1,000,000 in securities and other property (50% of paragraph (a)(1)(v)(A)(1)) and \$100,000 in exchange-specified initial margin and option premiums (50% of paragraph (a)(1)(v)(A)(2)).

(B) With respect to a qualified eligible client, that the person:

(1) Owns securities (including pool participations) of issuers not affiliated with such client and other investments with an aggregate market value of at least \$2,000,000;

<sup>98</sup> 5 USC 601 *et seq.* (1994 & Supp. II 1996).

<sup>99</sup> 47 FR 18618 (April 30, 1982).

<sup>100</sup> *Id.* at 18619-20.

<sup>101</sup> *Id.* at 18620.

(2) Has had on deposit with a futures commission merchant, for its own account at any time during the six-month period preceding the date that person opens an exempt account with the commodity trading advisor, at least \$200,000 in exchange-specified initial margin and option premiums for commodity interest transactions; or

(3) Owns a portfolio comprised of a combination of the funds or property specified in paragraphs (a)(1)(v)(B)(1) and (2) of this section in which the sum of the funds or property includable under paragraph (a)(1)(v)(B)(1), expressed as a percentage of the minimum amount required thereunder, and the amount of futures margin and option premiums includable in paragraph (a)(1)(v)(B)(2), expressed as a percentage of the minimum amount required thereunder, equals at least one hundred percent. An example of a composite portfolio acceptable under this paragraph (a)(1)(v)(B)(3) would consist of \$1,000,000 in securities and other property (50% of paragraph (a)(1)(v)(B)(1)) and \$100,000 in exchange-specified initial margin and option premiums (50% of paragraph (a)(1)(v)(B)(2)).

(vi) *United States* means the United States, its states, territories or possessions, or an enclave of the United States government, its agencies or instrumentalities.

(2) *Qualified eligible participants*—(i) Persons who are qualified eligible participants irrespective of the Portfolio Requirement. *Qualified eligible participant* means any person, acting for its own account or for the account of a qualified eligible participant, who the commodity pool operator reasonably believes, at the time of the sale to that person of a pool participation in the exempt pool, is:

(A) A futures commission merchant registered pursuant to section 4d of the Act, or a principal thereof;

(B) A broker or dealer registered pursuant to section 15 of the Securities Exchange Act of 1934, or a principal thereof;

(C) A commodity pool operator registered pursuant to section 4m of the Act, or a principal thereof; *Provided*, That the commodity pool operator:

(1) Has been registered and active as such for two years; or

(2) Operates pools which, in the aggregate, have total assets in excess of \$5,000,000;

(D) A commodity trading advisor registered pursuant to section 4m of the Act, or a principal thereof; *Provided*, That the commodity trading advisor:

(1) Has been registered and active as such for two years; or

(2) Provides commodity interest trading advice to commodity accounts which, in the aggregate, have total assets in excess of \$5,000,000 deposited at one or more futures commission merchants;

(E) An investment adviser registered pursuant to section 203 of the Investment Advisers Act of 1940 (the "Investment Advisers Act") or pursuant to the laws of any state, or a principal thereof; *Provided*, That the investment adviser:

(1) Has been registered and active as such for two years; or

(2) Provides securities investment advice to securities accounts which, in the aggregate, have total assets in excess of \$5,000,000 deposited at one or more registered securities brokers;

(F) A "qualified purchaser" as defined in section 2(51)(A) of the Investment Company Act of 1940 (the "Investment Company Act");

(G) A "knowledgeable employee" as defined in § 270.3c-5 of this title;

(H)(1) The commodity pool operator, commodity trading advisor or investment adviser of the exempt pool offered or sold, or an affiliate of any of the foregoing;

(2) A principal of the exempt pool or the commodity pool operator, commodity trading advisor or investment adviser of the exempt pool, or of an affiliate of any of the foregoing;

(3) An employee of the exempt pool, commodity pool operator, commodity trading advisor or investment adviser of the exempt pool, or of an affiliate of any of the foregoing (other than an employee performing solely clerical, secretarial or administrative functions with regard to such person or its investments) who, in connection with his or her regular functions or duties, participates in the investment activities of the exempt pool, other commodity pools operated by the commodity pool operator of the exempt pool or other accounts advised by the commodity trading advisor or the investment adviser of the exempt pool, or by the affiliate; *Provided*, That such employee has been performing such functions and duties for or on behalf of the exempt pool, commodity pool operator, commodity trading advisor, investment adviser or affiliate, or substantially similar functions or duties for or on behalf of another person engaged in providing commodity interest, securities or other financial services, for at least 12 months;

(4) Any other employee of the exempt pool, commodity pool operator, commodity trading advisor or investment adviser of the exempt pool, or of an affiliate of any of the foregoing (other than an employee performing solely clerical, secretarial or

administrative functions with regard to such person or its investments); *Provided*, That such employee:

(i) Is an accredited investor as defined in § 230.501(a)(5) or (6) of this title; and

(ii) Has been employed by the exempt pool, commodity pool operator, commodity trading advisor, investment adviser or affiliate, or by another person engaged in providing commodity interest, securities or other financial services, for at least 24 months; or

(5) The spouse, child, sibling or parent of a person who satisfies the criteria of paragraph (a)(2)(i)(H)(1), (2), (3) or (4) of this section; *Provided*, That:

(i) An investment in the exempt pool by any such family member is made with the knowledge and at the direction of the person; and

(ii) The family member is a qualified eligible participant only for the purposes of this paragraph

(a)(2)(i)(H)(5);

(I) A trust; *Provided*, That:

(1) The trust was not formed for the specific purpose of participating in the exempt pool; and

(2) The trustee or other person authorized to make investment decisions with respect to the trust, and each settlor or other person who has contributed assets to the trust, is a qualified eligible participant;

(J) An organization described in section 501(c)(3) of the Internal Revenue Code (the "IRC"); *Provided*, That the trustee or other person authorized to make investment decisions with respect to the organization, and the person who has established the organization, is a qualified eligible participant;

(K) A Non-United States person; or

(L) An entity in which all of the unit owners or participants are persons listed in paragraphs (a)(2)(i) and (a)(2)(ii) of this section.

(ii) Persons who must satisfy the Portfolio Requirement to be qualified eligible participants. *Qualified eligible participant* means any person who the commodity pool operator reasonably believes, at the time of the sale to that person of a pool participation in the exempt pool, satisfies the Portfolio Requirement and is:

(A) An investment company registered under the Investment Company Act or a business development company as defined in section 2(a)(48) of such Act not formed for the specific purpose of investing in the exempt pool;

(B) A bank as defined in section 3(a)(2) of the Securities Act of 1933 (the "Securities Act") or any savings and loan association or other institution as defined in section 3(a)(5)(A) of the Securities Act acting for its own account

or for the account of a qualified eligible participant;

(C) An insurance company as defined in section 2(13) of the Securities Act acting for its own account or for the account of a qualified eligible participant;

(D) A plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of \$5,000,000;

(E) An employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974 ("ERISA"); *Provided*, That the investment decision is made by a plan fiduciary, as defined in section 3(21) of such Act, which is a bank, savings and loan association, insurance company, or registered investment adviser; or that the employee benefit plan has total assets in excess of \$5,000,000; or, if the plan is self-directed, that investment decisions are made solely by persons that are qualified eligible participants;

(F) A private business development company as defined in section 202(a)(22) of the Investment Advisers Act;

(G) An organization described in section 501(c)(3) of the IRC, with total assets in excess of \$5,000,000;

(H) A corporation, Massachusetts or similar business trust, or partnership, other than a pool, which has total assets in excess of \$5,000,000, and is not formed for the specific purpose of participating in the exempt pool;

(I) A natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase in the exempt pool exceeds \$1,000,000;

(J) A natural person who had an individual income in excess of \$200,000 in each of the two most recent years or joint income with that person's spouse in excess of \$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year;

(K) Except as provided for the governmental entities referenced in paragraph (a)(2)(ii)(D) of this section, if otherwise authorized by law to engage in such transactions, a governmental entity (including the United States, a state, or a foreign government) or political subdivision thereof, or a multinational or supranational entity or an instrumentality, agency, or department of any of the foregoing; or

(L) A pool, trust, insurance company separate account or bank collective trust, with total assets in excess of \$5,000,000, not formed for the specific

purpose of participating in the exempt pool, and whose participation in the exempt pool is directed by a qualified eligible participant.

(3) Qualified eligible clients—(i) Persons who are qualified eligible clients irrespective of the Portfolio Requirement. Qualified eligible client means any person, acting for its own account or for the account of a qualified eligible client, who the commodity trading advisor reasonably believes, at the time that person opens an exempt account with the commodity trading advisor, is:

(A)(1) A person described in paragraph (a)(2)(i)(A), (B), (C), (D), (E), (F), (G) or (J) of this section;

(2) A person described in paragraph (a)(2)(i)(K) of this section; *Provided*, however, that the CTA who seeks to direct or guide the commodity interest trading account of the person:

(i) Provides commodity interest trading advice exclusively to persons who are qualified eligible clients, including persons described in paragraph (a)(2)(i)(K) of this section; and

(ii) Has filed a notice of claim for exemption pursuant to paragraph (c) of this section;

(B)(1) An affiliate of the commodity trading advisor of the exempt account;

(2) A principal of the commodity trading advisor of the exempt account or of an affiliate of the trading advisor;

(3) An employee of the commodity trading advisor of the exempt account or of an affiliate of the trading advisor (other than an employee performing solely clerical, secretarial or administrative functions with regard to such person or its investments) who, in connection with his or her regular functions or duties, participates in the investment activities of the commodity trading advisor or the affiliate; *Provided*, That such employee has been performing such functions and duties for or on behalf of the commodity trading advisor or the affiliate, or substantially similar functions or duties for or on behalf of another person engaged in providing commodity interest, securities or other financial services, for at least 12 months;

(4) Any other employee of the commodity trading advisor of the exempt account or of an affiliate of the trading advisor (other than an employee performing solely clerical, secretarial or administrative functions with regard to such person or its investments); *Provided*, That such employee:

(i) Is an accredited investor as defined in § 230.501(a)(5) or (6) of this title; and

(ii) Has been employed by the commodity trading advisor or the affiliate, or by another person engaged

in providing commodity interest, securities or other financial services, for at least 24 months; or

(5) The spouse, child, sibling or parent of the commodity trading advisor of the exempt account or of a person who satisfies the criteria of paragraph (a)(3)(i)(B)(1), (2), (3) or (4) of this section; *Provided*, That:

(i) The establishment of an exempt account by any such family member is made with the knowledge and at the direction of the trading advisor or person; and

(ii) The family member is a qualified eligible client only for the purposes of this paragraph (a)(3)(i)(B)(5);

(C) A Trust; *Provided*, That:

(1) The trust was not formed for the specific purpose of opening an exempt account with the commodity trading advisor; and

(2) The trustee or other person authorized to make investment decisions with respect to the trust, and each settlor or other person who has contributed assets to the trust, is a qualified eligible client;

(D) An exempt pool; or

(E) An entity in which all of the unit owners or participants, other than the commodity trading advisor claiming relief under this section, are persons listed in paragraphs (a)(3)(i)(A) through (D) and (a)(3)(ii) of this section.

(F) Notwithstanding paragraph (a)(3)(ii) of this section, an entity as to which a notice of eligibility has been filed pursuant to § 4.5 which is operated in accordance with such rule and in which all unit owners or participants, other than the commodity trading advisor claiming relief under this section, are qualified eligible participants.

(ii) Persons who must satisfy the Portfolio Requirement to be qualified eligible clients. Qualified eligible client means any person who the commodity trading advisor reasonably believes, at the time that person opens an exempt account with the commodity trading advisor, satisfies the Portfolio Requirement and is:

(A) An investment company registered under the Investment Company Act or a business development company as defined in section 2(a)(48) of that Act not formed for the specific purpose of opening an exempt account with the commodity trading advisor;

(B) A bank as defined in section 3(a)(2) of the Securities Act, or any savings and loan association or other institution as defined in section 3(a)(5)(A) of the Securities Act acting for its own account or for the account of a qualified eligible client;

(C) An insurance company as defined in section 2(13) of the Securities Act acting for its own account or for the account of a qualified eligible client;

(D) A plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of \$5,000,000;

(E) An employee benefit plan within the meaning of ERISA; *Provided*, That the investment decision is made by a plan fiduciary, as defined in section 3(21) of such Act, which is a bank, savings and loan association, insurance company, or registered investment adviser; or that the employee benefit plan has total assets in excess of \$5,000,000; or if the plan is self-directed, that investment decisions are made solely by persons that are qualified eligible clients;

(F) A private business development company as defined in section 202(a)(22) of the Investment Advisers Act;

(G) An organization described in section 501(c)(3) of the IRC, with total assets in excess of \$5,000,000;

(H) A corporation, Massachusetts or similar business trust, or partnership, other than a pool, which has total assets in excess of \$5,000,000, and is not formed for the specific purpose of opening an exempt account with the commodity trading advisor;

(I) A natural person whose individual net worth, or joint net worth with that person's spouse, at the time that person opens an exempt account exceeds \$1,000,000;

(J) A natural person who had an individual income in excess of \$200,000 in each of the two most recent years or joint income with that person's spouse in excess of \$300,000 in each of those years and has reasonable expectation of reaching the same income level in the current year;

(K) Except as otherwise provided in paragraph (a)(3)(ii)(D) of this section, if otherwise authorized by law to engage in such transactions, a governmental entity (including the United States, a state, or a foreign government) or political subdivision thereof, or a multinational or supranational entity or an instrumentality, agency, or department of any of the foregoing;

(L) A trust, insurance company separate account or bank collective trust, with total assets in excess of \$5,000,000, not formed for the specific purpose of opening an exempt account with the commodity trading advisor, whose investment in the exempt

account is directed by a qualified eligible client or participant.

(b) Relief for commodity pool operators. Subject to the conditions specified in paragraph (b)(2) of this section, any registered commodity pool operator who offers or sells participations in a pool solely to qualified eligible participants in an offering which qualifies for exemption from the registration requirements of the Securities Act pursuant to section 4(2) of that Act or pursuant to Regulation S, 17 CFR 230.901 *et seq.*, and any bank registered as a commodity pool operator in connection with a pool that is a collective trust fund whose securities are exempt from registration under the Securities Act pursuant to section 3(a)(2) of that Act and are offered or sold, without marketing to the public, solely to qualified eligible participants, may claim any or all of the following relief with respect to such pool by filing the notice required by paragraph (b)(2) of this section.

(1) Relief—(i) Disclosure. (A) Exemption from the specific requirements of §§ 4.21, 4.24, 4.25 and 4.26 with respect to each exempt pool; *Provided*, That if an offering memorandum is distributed in connection with soliciting prospective participants in the exempt pool, such offering memorandum must include all disclosures necessary to make the information contained therein, in the context in which it is furnished, not misleading; and that the following statement is prominently disclosed on the cover page of the offering memorandum, or, if none is provided, immediately above the signature line on the subscription agreement or other document that the prospective participant must execute to become a participant in the pool: "PURSUANT TO AN EXEMPTION FROM THE COMMODITY FUTURES TRADING COMMISSION IN CONNECTION WITH POOLS WHOSE PARTICIPANTS ARE LIMITED TO QUALIFIED ELIGIBLE PARTICIPANTS, AN OFFERING MEMORANDUM FOR THIS POOL IS NOT REQUIRED TO BE, AND HAS NOT BEEN, FILED WITH THE COMMISSION. THE COMMODITY FUTURES TRADING COMMISSION DOES NOT PASS UPON THE MERITS OF PARTICIPATING IN A POOL OR UPON THE ADEQUACY OR ACCURACY OF AN OFFERING MEMORANDUM. CONSEQUENTLY, THE COMMODITY FUTURES TRADING COMMISSION HAS NOT REVIEWED OR APPROVED THIS OFFERING OR ANY OFFERING MEMORANDUM FOR THIS POOL."

(B) Exemption from disclosing the past performance of exempt pools in the Disclosure Document of non-exempt pools except to the extent that such past performance is material to the non-exempt pool being offered; *Provided*, *however*, That a pool operator that has claimed exemption hereunder and elects not to disclose any such performance in the Disclosure Document of non-exempt pools shall state in a footnote to the performance disclosure therein that the operator is operating or has operated exempt pools whose performance is not disclosed in this Disclosure Document.

(ii) Periodic reporting. Exemption from the specific requirements of §§ 4.22(a) and (b); *Provided*, That a statement signed and affirmed in accordance with § 4.22(h) is prepared and distributed to pool participants no less frequently than quarterly within 30 calendar days after the end of the reporting period. This statement must indicate:

(A) The net asset value of the exempt pool as of the end of the reporting period;

(B) The change in net asset value from the end of the previous reporting period; and

(C) The net asset value per outstanding unit of participation in the exempt pool as of the end of the reporting period.

(iii) Annual report. (A) Exemption from the specific requirements of §§ 4.22(c) and (d); *Provided*, That within 90 calendar days after the end of the exempt pool's fiscal year, the commodity pool operator files with the Commission and with the National Futures Association and distributes to each participant in lieu of the financial information and statements specified by those sections, an annual report for the exempt pool, signed and affirmed in accordance with § 4.22(h) which contains, at a minimum:

(1) A Statement of Financial Condition as of the close of the exempt pool's fiscal year (elected in accordance with § 4.22(g));

(2) A Statement of Income (Loss) for that year; and

(3) Appropriate footnote disclosure and any other material information.

(B) Such annual report must be presented and computed in accordance with generally accepted accounting principles consistently applied and, if certified by an independent public accountant, so certified in accordance with § 1.16 as applicable.

(C) Legend. (1) If a claim for exemption has been made pursuant to this section, the commodity pool operator must make a statement to that

effect on the cover page of each annual report.

(2) If the annual report is not certified in accordance with § 1.16, the pool operator must make a statement to that effect on the cover page of each annual report and state that a certified audit will be provided upon the request of the holders of a majority of the units of participation in the pool who are unaffiliated with the commodity pool operator.

(iv) Recordkeeping. Exemption from the specific requirements of § 4.23; *Provided*, That the commodity pool operator must maintain the reports referred to in paragraphs (b)(1)(ii) and (b)(1)(iii) of this section and all books and records prepared in connection with his activities as the pool operator of the exempt pool (including, without limitation, records relating to the qualifications of qualified eligible participants and substantiating any performance representations) at his main business address and must make such reports and records available to any representative of the Commission, the National Futures Association and the United States Department of Justice in accordance with the provisions of § 1.31.

(2) Notice of claim for exemption. (i) The notice of a claim for exemption under this section must:

(A) Be in writing;

(B) Provide the name, main business address, main business telephone number and the National Futures Association commodity pool operator identification number of the person claiming the exemption;

(C) Provide the name(s) of the pool(s) for which the request is made; *Provided*, That a single notice representing that the commodity pool operator anticipates operating single-investor pools may be filed to claim exemption for single-investor pools and such notice need not name each such pool;

(D) Contain representations that:

(1) Neither the commodity pool operator nor any of his principals is subject to any statutory disqualification under section 8a(2) or 8a(3) of the Act unless such disqualification arises from a matter which was previously disclosed in connection with a previous application for registration if such registration was granted or which was disclosed more than thirty days prior to the filing of the notice under this paragraph (b)(2)(i)(D);

(2) The commodity pool operator will comply with the applicable requirements of § 4.7; and

(3) The exempt pool will be offered and operated in compliance with the applicable requirements of § 4.7;

(E) Specify the relief claimed under § 4.7;

(F) State the closing date of the offering or that the offering will be continuous;

(G) Be signed by the pool operator, as follows:

If the pool operator is a sole proprietorship, by the sole proprietor; if a partnership, by a general partner; and if a corporation, by the chief executive officer or chief financial officer;

(H) Be filed in duplicate with the Commission at the address specified in § 4.2 and with the National Futures Association at its headquarters office (Attn: Director of Compliance, Compliance Department); and

(I)(1) Except as provided in paragraph (b)(2)(i)(C) of this section with respect to single-investor pools and in paragraph (b)(2)(i)(I)(2) of this section, be received by the Commission:

(i) Before the date the pool first enters into a commodity interest transaction, if the relief claimed is limited to that provided under paragraphs (b)(1)(ii), (iii) and (iv) of this section; or

(ii) Prior to any offer or sale of any participation in the exempt pool if the claimed relief includes that provided under paragraph (b)(1)(i) of this section.

(2) Where participations in a pool have been offered or sold in full compliance with this part 4, the notice of a claim for exemption may be filed with the Commission at any time; *Provided*, That the claim for exemption is otherwise consistent with the duties of the commodity pool operator and the rights of pool participants and that the commodity pool operator notifies the pool participants of his intention, absent objection by the holders of a majority of the units of participation in the pool who are unaffiliated with the commodity pool operator within twenty-one days after the date of the notification, to file a notice of claim for exemption under § 4.7 and such holders have not objected within such period. A commodity pool operator filing a notice under this paragraph (b)(2)(i)(I)(2) shall either provide disclosure and reporting in accordance with the requirements of this part 4 to those participants objecting to the filing of such notice or allow such participants to redeem their units of participation in the pool within three months of the filing of such notice.

(ii) The notice will be effective upon receipt by the Commission with respect to each pool for which it was made; *Provided*, That any notice which does not include all the required information shall not be effective, and that if at the time the Commission receives the notice, an enforcement proceeding brought by the Commission under the

Act or the regulations is pending against the commodity pool operator or any of its principals, the exemption will not be effective until twenty-one calendar days after receipt of the notice by the Commission and that in such case an exemption may be denied by the Commission or made subject to such conditions as the Commission may impose.

(iii) Any exemption claimed hereunder shall cease to be effective with respect to a particular pool upon any change which would cause the commodity pool operator for the pool to be ineligible for the relief claimed with respect to such pool. The commodity pool operator must promptly file a notice advising the Commission of such change.

(3) Any exemption from the requirements of § 4.21, 4.22, 4.23, 4.24, 4.25 or 4.26 with respect to a pool shall not affect the obligation of the commodity pool operator to comply with all other applicable provisions of Part 4, the Act and the Commission's rules and regulations, with respect to the pool and with respect to any other pool such pool operator operates or intends to operate.

(c) Relief for commodity trading advisors. Subject to the conditions specified in paragraph (c)(2) of this section and upon filing the notice required by paragraph (c)(2) of this section, any registered commodity trading advisor who anticipates directing or guiding the commodity interest accounts of qualified eligible clients will be exempt as follows with respect to the accounts of qualified eligible clients who have given due consent to their account being an exempt account under § 4.7.

(1) Relief—(i) Disclosure. (A) Exemption from the specific requirements of §§ 4.31, 4.34, 4.35 and 4.36; *Provided*, That if the commodity trading advisor delivers a brochure or other disclosure statement to such qualified eligible clients, such brochure or statement shall include all additional disclosures necessary to make the information contained therein, in the context in which it is furnished, not misleading; and that the following statement is prominently displayed on the cover page of the brochure or statement or, if none is provided, immediately above the signature line of the agreement that the client must execute before it opens an account with the commodity trading advisor: "PURSUANT TO AN EXEMPTION FROM THE COMMODITY FUTURES TRADING COMMISSION IN CONNECTION WITH ACCOUNTS OF QUALIFIED ELIGIBLE CLIENTS, THIS

BROCHURE OR ACCOUNT DOCUMENT IS NOT REQUIRED TO BE, AND HAS NOT BEEN, FILED WITH THE COMMISSION. THE COMMODITY FUTURES TRADING COMMISSION DOES NOT PASS UPON THE MERITS OF PARTICIPATING IN A TRADING PROGRAM OR UPON THE ADEQUACY OR ACCURACY OF COMMODITY TRADING ADVISOR DISCLOSURE. CONSEQUENTLY, THE COMMODITY FUTURES TRADING COMMISSION HAS NOT REVIEWED OR APPROVED THIS TRADING PROGRAM OR THIS BROCHURE OR ACCOUNT DOCUMENT.”

(B) Exemption from disclosing the past performance of exempt accounts in the Disclosure Document for non-exempt accounts except to the extent that such past performance is material to the non-exempt account being offered; *Provided, however*, That a commodity trading advisor that has claimed exemption hereunder and elects not to disclose any such performance in the Disclosure Document for non-exempt accounts shall state in a footnote to the performance disclosure therein that the advisor is advising or has advised exempt accounts for qualified eligible clients whose performance is not disclosed in this Disclosure Document.

(ii) Recordkeeping. Exemption from the specific requirements of § 4.33; *Provided*, That the commodity trading advisor must maintain, at its main business office, all books and records prepared in connection with his activities as the commodity trading advisor of the qualified eligible clients (including, without limitation, records relating to the qualifications of such qualified eligible clients and substantiating any performance representations) and must make such records available to any representative of the Commission, the National Futures Association and the United States Department of Justice in accordance with the provisions of § 1.31.

(2) Notice of claim for exemption. (i) The notice of a claim for exemption under this section must:

(A) Be in writing;

(B) Provide the name, main business address, main business telephone number and the National Futures Association commodity trading advisor identification number of the person claiming the exemption;

(C) Contain a representation that the commodity trading advisor anticipates providing commodity interest trading advice to qualified eligible clients and that it will comply with the applicable requirements of § 4.7 with respect to accounts of such clients;

(D) Contain a representation that neither the commodity trading advisor nor any of its principals is subject to any statutory disqualification under section 8a(2) or 8a(3) of the Act unless such disqualification arises from a matter which was previously disclosed in connection with a previous application for registration if such registration was granted or which was disclosed more than thirty days prior to the filing of the notice under this paragraph;

(E) Specify the relief claimed under § 4.7;

(F) Be signed by the commodity trading advisor, as follows: If the commodity trading advisor is a sole proprietorship, by the sole proprietor; if a partnership, by a general partner; and if a corporation, by the chief executive officer or chief financial officer;

(G) Be filed in duplicate with the Commission at the address specified in § 4.2 and with the National Futures Association at its headquarters office (Attn: Director of Compliance, Compliance Department); and

(H) Be received by the Commission before the date the commodity trading advisor first enters into an agreement to direct or guide the commodity interest account of a qualified eligible client pursuant to § 4.7.

(ii) The notice will be effective upon receipt by the Commission; *Provided*, That any notice which does not include all of the required information shall not be effective, and that if at the time the Commission receives the notice, an enforcement proceeding brought by the Commission under the Act or the regulations is pending against the commodity trading advisor or any of its principals, the exemption will not be effective until twenty-one calendar days after receipt of the notice by the Commission and that in such case an exemption may be denied by the Commission or made subject to such conditions as the Commission may impose.

(iii) Any exemption claimed hereunder shall cease to be effective upon any change which would cause the commodity trading advisor to be ineligible for the relief claimed. The commodity trading advisor must promptly file a notice advising the Commission of such change.

(3) Any exemption from the requirements of § 4.31, 4.33, 4.34, 4.35 or 4.36 made hereunder shall not affect the obligation of the commodity trading advisor to comply with all other applicable provisions of part 4, the Act and the Commission's rules and regulations, with respect to any qualified eligible client and with respect to any other client to which the

commodity trading advisor provides or intends to provide commodity interest trading advice.

(d) Insignificant deviations from a term, condition or requirement of § 4.7. (1) A failure to comply with a term or condition of § 4.7 will not result in the loss of the exemption with respect to a particular pool or client if the commodity pool operator or the commodity trading advisor relying on the exemption shows that:

(i) The failure to comply did not pertain to a term, condition or requirement directly intended to protect that particular qualified eligible participant or client;

(ii) The failure to comply was insignificant with respect to the exempt pool as a whole or to the particular qualified eligible client of the commodity trading advisor; and

(iii) A good faith and reasonable attempt was made to comply with all applicable terms, conditions and requirements of § 4.7.

(2) A transaction made in reliance on § 4.7 must comply with all applicable terms, conditions and requirements of § 4.7. Where an exemption is established only through reliance upon paragraph (d)(1) of this section, the failure to comply shall nonetheless be actionable by the Commission.

Issued in Washington, D.C. on February 17, 2000, by the Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 00-4746 Filed 3-1-00; 8:45 am]

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## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[REG-103735-00]

RIN 1545-AX81

#### Tax Shelter Disclosure Statements

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Cross-reference notice of proposed rulemaking and notice of public hearing.

**SUMMARY:** In the Rules and Regulations portion of this issue of the **Federal Register**, the IRS is issuing temporary regulations requiring certain corporate taxpayers to file a statement under section 6011 and maintain certain documents under section 6001. The temporary regulations affect corporations participating in certain reportable transactions. The text of