CFTC Letter No. 00-92

September 20, 2000

Exemption

Division of Trading & Markets

Re: Rule 4.7(a): Request for Exemption to Claim Relief Notwithstanding the Participation of Certain Employees in a Rule 4.7 Exempt Fund

---

Dear :

This is in response to your letter dated August 4, 2000 to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by telephone conversations with Commission staff. By your correspondence, you request an exemption from the qualified eligible person ("QEP") criteria of Rule 4.7(a)[1] on behalf of "P", the principal investment advisor to "Q",[2] so that "P" may claim relief under Rule 4.7, notwithstanding the participation of certain of its employees in "Q", which will be operated as an exempt pool under Rule 4.7(a).

Facts

Based upon the representations made in your correspondence, we understand the facts to be as follows. By letters dated January 17, 1984 and April 9, 1991, and orally in response to a letter dated November 18, 1991 (the "Letters"), the Division took no-action positions with respect to "P"[3] and "R", their principals and associated persons for "P's" and "R's" failure to register with the Commission in connection with their operation of "Q" and certain other collective investment vehicles (collectively, the "Funds").[4] This relief was based upon, among other things, representations that: (1) the Funds were organized outside the United States; (2) the principal business purpose of each Fund was to enable foreign investors to trade in securities; (3) "P" would not commit more than five percent of any Fund's assets for initial margin deposits and premiums for commodity futures contracts and options thereon; and (4) shares of a Fund would not be owned or transferred to any United States person other than (a) investment professionals having substantial responsibilities in managing a Fund ("Qualified Employees") and their family members; and (b) private personal or charitable trusts or foundations created by any of the foregoing persons.

By letter dated May 20, 1992 (also a "Letter"),[5] "P" and "R" were granted continued no-action relief in response to their request to expand the class of United States persons permitted to invest in the Funds to include all employees of "P", subject to "P's" and "R's" compliance with certain conditions, specifically that:

1. “P” would provide offering memoranda to all employees containing the same substantive information, including the same quarterly and annual financial data, that a CPO must furnish when claiming the relief available pursuant to Rule 4.12(b). All memoranda would indicate that “P” was not registered in any capacity with the Commission.

2. “P” would disclose in writing to all employees that ownership of an interest in any of the Funds was not mandatory, and that an employee’s decision whether to invest in the Funds would not be considered in any evaluation of the employee’s performance or advancement.

3. “P” would not permit a non-Qualified Employee to purchase shares in any of the Funds unless, after such purchase was made, the value of all equity interests in such Fund owned by all non-Qualified Employees in the aggregate would be less than one percent of the value of the Fund’s total equity.

4. Promptly following the close of each fiscal year, “P” would rebate to each non-Qualified Employee a cash payment equal to all fees accrued in favor of “P” by a Fund with respect to the investment in that Fund by such non-Qualified Employee during such fiscal year.

5. In the case of an investment for the benefit of any self-directed employee benefit plan sponsored by “P”, “P” would not permit an investment in any Fund as an investment alternative available to plan participants unless, at the time of such investment, there were at least two publicly-offered domestic investment funds specializing in common stock investments that were also available to participants in the plan.

6. Futures trading in a Fund would be secondary to that Fund’s securities trading activities and not more than five percent of the total assets of a Fund would be committed as initial margin or premiums for futures and options on futures.

At the time the Division issued the prior Letters, “P” served either as the principal investment advisor or the asset manager of each of the Funds, while “R” served as the Managing Director of each of the Funds. In this capacity, “R” provided corporate management, accounting, administrative, and clerical services for the Funds.

“P” now intends to become registered as a CPO and CTA with the Commission in order to offer futures-related products and services to United States persons. Once registered, “P” intends to claim exemption under Rule 4.7 with respect to any pools or accounts it offers, including “Q”. Notwithstanding the requirements of Rule 4.7, however, “P” requests that the Division extend the relief it previously granted with respect to investments in “Q” made by “P” employees, both prior to and following “P’s” registration as a CPO and CTA, such that they may continue to maintain their investment in “Q”. This relief would be limited to those “P” employees who were investors in “Q” prior to the effective date of “P’s” registration with the Commission (“Invested Employees”).[6] Currently, there are 81 Invested Employees, 45 of whom have been Invested Employees for over two years. Their positions range from Executive Officer to

Administrative Assistant. Because of the nature of their positions, or because they may not have performed their functions or duties, or substantially similar functions or duties, for the requisite period of time, some of the Invested Employees are not QEPs as defined in Rule 4.7.[7] All of the Invested Employees purchased shares in "Q" through the "Profit Sharing Plan".[8]

In support of your request, you represent that "P" has complied with all of the conditions set forth in the May 20, 1992 Letter. In this regard, you note that as required by the 1992 Letter, the Profit Sharing Plan offers several different investment options, including the publicly-offered investment companies "PP", "QQ", "RR", "SS", and "TT". Thus, all of the Invested Employees have been provided with investment options and they have chosen to invest in the Funds. You further represent that "P" will continue to comply with the conditions set forth in the May 20, 1992 Letter following its registration with the Commission for so long as any Invested Employee remains invested in "Q".

Discussion

You have requested exemptive relief from the QEP criteria of Rule 4.7(a) with respect to: (1) investments in "Q" made by Invested Employees prior to the date of registration of "P" with the Commission as a CPO and CTA; and (2) any investments in "Q" made by Invested Employees after the date of registration of "P". Absent relief, "P" would not be able to treat "Q" as an exempt pool under Rule 4.7 because not all of "Q's" participants are QEPs. In this regard, the instant request provides a stronger basis upon which to grant relief than the bases of the prior Letters in that "P" will be registered as a CPO and CTA.

Based upon the foregoing representations, the Division does not believe that granting your request would be contrary to the public interest or the purpose of Rule 4.7(a). Accordingly, by the authority delegated under Rule 140.93(a)(1), the Division hereby grants "P" an exemption from the QEP criteria of Rule 4.7(a) such that it may claim relief pursuant to Rule 4.7 with respect to "Q", notwithstanding the investments of the Invested Employees in "Q" prior and subsequent to effectiveness of "P's" registration as a CPO and CTA.[9]

This letter does not excuse "P" from compliance with any otherwise applicable requirements contained in the Act or in the Commission's regulations issued thereunder. For example, "P" remains subject to all antifraud provisions of the Act and the Commission's regulations, the reporting requirements for traders set forth in Parts 15, 18, and 19 of the Commission's regulations and to all otherwise applicable provisions of Part 4. Moreover, this letter is applicable to "P" solely in connection with investments in "Q" made by Invested Employees prior to and after the date of "P's" registration as a CPO and CTA.

This letter, and the exemption granted herein, are based upon the representations that have been made to us, and are subject to "P's" continued compliance with the conditions set forth in the May 20, 1992 Letter.[10] Any different, changed, or omitted material facts or circumstances might render this exemption void. You must notify us immediately in the event the operations or activities of "P" or "Q", including the composition of the Invested Employees in "Q", change in any material way from those represented to us.

If you have any questions concerning this correspondence, please contact Ky Tran-Trong, an attorney on my staff, at (202) 418-5452.

Very
truly
yours,

John C.
Lawton
Acting
Director

1 While your original request sought an extension of previously granted "no-action" positions (discussed below), following telephone conversations with staff on August 16, 2000, the Division is treating it as a request for exemption from the QEP criteria of Rule 4.7(a).

Rule 4.7 recently was revised by the Commission. *See* 65 Fed. Reg. 47848 (Aug. 4, 2000). All other Commission rules referred to herein are found at 17 C.F.R. Ch. I (2000).

2 "Q" was formerly known as "S".

3 The January 17, 1984 Letter granted relief to "Z", then a New York corporation. Subsequent to the issuance of that Letter, "Z" became a sole proprietorship. On January 1, 1997, "P" succeeded to the business of the sole proprietorship. "P" is owned and operated by "A".

4 The Funds covered by the prior Letters included "S", "T", "U", "V" and "W". Effective February 1, 1999, "T" and "U" were combined with and into "Q". Effective July 1, 2000, "V" was also combined with and into "Q". "P" anticipates that "W" will be merged into "Q" on or about October 1, 2000. This letter applies to "Q" as it is currently constituted, as well as once "W" is combined with and into "Q".

5 The May 20, 1992 Letter incorporated all prior Letters by reference. Similarly, this letter incorporates all prior Letters by reference, including the May 20, 1992 Letter.

6 The term "Invested Employees" includes certain employees of "X", currently a separate entity that is an affiliate of "P", which was a part of "P" until January 1, 2000. The term does not, however, include "A" and members of his family who have invested in "Q" directly, each of whom is a QEP under Rule 4.7.

7 *See* the QEP criteria of Rules 4.7(a)(2)(viii)(A)(3) and (A)(4) for pool participants and Rules 4.7(a)(2)(viii)(B)(3) and (B)(4) for managed account clients.

8 Under "P's" current policy, certain of the Invested Employees would be eligible to purchase shares in "Q" directly because they qualify as accredited investors under Regulation D of the Securities Act of 1933. *See* 17 C.F.R. § 230.501. However, to date, no such employee has elected to invest in "Q" directly. None

of the remaining Invested Employees has been permitted to acquire shares in "Q" except through the Profit Sharing Plan.

9 "P" will serve as the CPO and CTA of "Q" upon its registration, and from that time, "R" will be performing solely administrative functions for "Q". Accordingly, additional relief need not be granted to "R".

10 "P" will of course no longer be required to state that it is not registered with the Commission in any capacity in any disclosure documents that it may provide to Invested Employees.