96-59

U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5430
Facsimile: (202) 418-5536

DIVISION OF
TRADING & MARKETS

July 23, 1996

Re: Rule 4.7: Request for No-Action Relief from the Ten Percent Restriction for a Pool That Has Non-QEPs

Dear :

This is in response to your letter dated April 24, 1996 to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission") as supplemented by telephone conversations with Division staff. By your correspondence, you request relief on behalf of "U", a registered commodity pool operator ("CPO"),[1] in connection with its operation of "V", from the restrictions of Commission Rule 4.7(a)(1)(ii)(B)(2)(xi),[2] which would prevent "U" from investing more than ten percent of the assets of "V" in a Rule 4.7 exempt pool ("ten percent restriction") because not all investors in "V" are qualified eligible participants ("QEPs") as that term is defined in Rule 4.7(a).

Based upon the representations made in your correspondence, we understand the pertinent facts to be as follows. "V" was formed on August 11, 1986 to seek capital appreciation through the speculative trading of futures. "A", the sole principal of "U", has acted as general partner and CPO of "V".[3] As of March 31, 1996, "V" had net assets of approximately $5,352,000. Approximately, thirty-nine percent of "V's" assets are invested in "W", a pool for which "U" serves as the CPO.[4] The remaining

---

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

2/ Commission rules referred to herein are found at 17 C.F.R. Ch. I (1995), as amended by 60 Fed. Reg. 38,146, (July 25, 1995).

3/ In addition to being the listed principal of "U", "A" is also registered as a CTA and CPO in his individual capacity.

4/ "W" is not operated pursuant to an exemption under Rule 4.7 and is therefore subject to the disclosure requirements of Rules

(continued...)

assets are invested in other pools or under the management of registered CTAs.

The limited partnership agreement of "V" is currently in the process of being amended to (a) substitute "U" for "A" as the general partner of "V"; (b) allow "V" to invest in securities both directly and indirectly through the purchase of interests in other investment funds, including investment funds associated with "U"; and (c) make certain other amendments not relevant to the no-action relief requested herein. Once these amendments have been approved, "V's" entire interest in "W" will be redeemed and the proceeds of the redemption will be invested in the "X", a new pool organized as a Delaware limited partnership on March 1, 1996 and of which "U" serves as general partner and CPO. Prior to any change in the allocation of "V's" assets, each limited partner in "V" will be notified of the intended change and will have the opportunity to redeem any limited partnership interests in "V" within ten days of receipt of such notice. "U" intends to operate "X" as a Rule 4.7 exempt pool.5/

"X" was organized for the purpose of seeking capital appreciation through investments in commodity interests, securities and hybrid instruments. Initially up to approximately fifty percent of "X's" net assets will be invested in "W". The remaining (approximately) fifty percent of "X's" assets will be managed by "U" in a managed account pursuant to "U's" proprietary "Y" securities trading program. "V's" investment represents "X's" "seed capital" and will allow "X" to begin trading immediately. However, "U" intends to offer interests in "X" to (other) members of the public who qualify as QEPs.

The changes described above are being undertaken to allow "V" to diversify its portfolio and include equity investments. This will be done through its investment in "X", which, as already mentioned, will invest part of its assets in securities. You indicated that to the extent these changes would result in a material change in the fee load paid by investors in "V", this fact would be fully disclosed to "V's" limited partners in connection

---

4/ (...continued)
4.21, 4.24, 4.25 and 4.26 and the reporting requirements of Rule 4.22.

5/ You indicated that since "U's" ability to operate "X" as a Rule 4.7-exempt pool is dependent in part on receiving the relief requested herein, "U" does not expect to file a notice of a claim of exemption under Rule 4.7(a) until it receives this response. Neither "V" nor "W" is a Rule 4.7 exempt pool.

with their receiving notice of the contemplated transaction and an opportunity to redeem their interests.

"V" is now operated, and will continue to be operated after its investment in "X", as a non-exempt pool, subject to the disclosure requirements of Rules 4.21, 4.24, 4.25 and 4.26, the reporting requirements of Rule 4.22 and all other applicable requirements of Part 4. Although "V" itself qualifies as a QEP, it does not qualify as a Rule 4.7 exempt pool because not all the investors in "V" are QEPs.[6/] Thus, it remains subject to the ten percent restriction of Rule 4.7(a) and therefore could not invest more than ten percent of its assets in "X", if "X" were operated as a Rule 4.7 exempt pool. Since "V" wishes to invest initially approximately thirty-nine percent of its assets in "X", you are requesting that the Division confirm that it will not recommend enforcement action against "U", upon "U's" becoming the general partner and CPO of "V", for violation of the ten percent restriction of Rule 4.7(a), if "V" invests more than ten percent of its assets in "X" as described above.

Based upon the facts you have represented to us, including your representations that "U" will be the general partner and CPO of "V", "X", and "W", it appears that granting the requested relief would not be contrary to the public interest and the purposes of Rule 4.7. Accordingly, the Division will not recommend that the Commission commence any enforcement action against "U" for violation of the ten percent restriction of Rule 4.7(a) if, upon its becoming the general partner and CPO of "V", "U" commits more than ten percent of "V's" assets to "X". We note that this letter relieves "U" of the requirements of the ten percent restriction of Rule 4.7(a) solely in connection with "V's" investment in "X", and does not excuse "U" from compliance with any other applicable requirements contained in the Commodity Exchange Act ("Act")[7/] or the Commission's regulations issued thereunder. For example, "U" remains subject to the antifraud provisions of Section 4o of the Act,[8/] the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's regulations, and all other applicable requirements of Part 4.

6/ "V" qualifies as a QEP because it meets the portfolio tests of Rule 4.7(a)(1)(B)(1), and is a pool with assets in excess of $5,000,000 and not formed for the specific purpose of purchasing interests in an exempt pool, as required under Rule 4.7(a)(1(ii)(B)(2(xi).

7/ 7 U.S.C. § 1 et seq. (1994).

8/ 7 U.S.C. § 6o (1994).

This letter is based upon your representations. Any different, changed or omitted facts or circumstances might require us to reach a different conclusion. In this regard, we request that you notify us immediately in the event that the operations or activities of "U", "V" or "X" change in any way from those represented to us. This letter represents the position of this Division only. It does not necessarily represent the views of the Commission or any other division or office of the Commission.

If you have any questions concerning this correspondence, please contact me or Thomas E. Joseph, an attorney on my staff, at (202) 418-5450.

Very truly yours,

Susan C. Ervin
Chief Counsel