



## U.S. COMMODITY FUTURES TRADING COMMISSION

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96-64

DIVISION OF  
TRADING & MARKETS

August 12, 1996

Re: Request to Treat Investors as Qualified Eligible Participants under Rule 4.7

Dear:

This is in response to your letter dated July 3, 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 from the qualified eligible participant ("QEP") criteria of Rule 4.7(a)<sup>1/</sup> on behalf of "N", a registered commodity pool operator ("CPO"), with regard to "the Fund", a commodity pool operated by "N" that invests primarily in mortgage-backed securities.

Based upon your representations, we understand the relevant facts to be as follows. The Fund has been operated pursuant to the criteria of Rule 4.7(a).<sup>2/</sup> "N" now wishes to admit certain non-QEP investors ("Non-QEP Investors") into the Fund. All of these Non-QEP Investors are members of "N" or employees of "O", a registered commodity trading advisor that is owned by the persons who own "N". Specifically, the Non-QEP Investors are:

- (1) "A", a portfolio manager for "O", who is registered as an associated person ("AP") of both "N" and "O". "A", who has a master's degree in business, formerly structured and traded agency collateralized mortgage obligations ("CMOs") at "P".
- (2) "B", a certified public accountant, who is the chief financial officer of "O" and is responsible for super-

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<sup>1/</sup> Commission rules referred to herein are found at 17 C.F.R. Ch. I (1996).

<sup>2/</sup> Pursuant to a Notice of Claim for Exemption under Rule 4.7, filed by "N" on August 1, 1995, interests in the Fund may be sold only to QEPs. As of May 31, 1996, the Fund had approximately \$142 million in net assets.

vising the accounting, operations, reporting and compliance functions of the Fund and "O". "B", who has sixteen years of public accounting experience and a master's degree in accounting, formerly was an audit partner at "Q" where she specialized in serving financial institutions.

- (3) "C", an "O" employee, who has primary responsibility at "O" for clearance and for the collection and tracking of payments on the Fund's mortgage positions. "C", who has twenty years of experience in fixed income clearing and operations and an associate degree in finance, formerly was responsible for clearing mortgages for "R", "S" and "P".
- (4) "D", a member of "N", who is responsible for the design of computer models to evaluate and hedge the Fund's portfolio. "D", who is an economics professor and has a doctorate in economics, formerly was a managing director of "P", where he led the design of the firm's proprietary mortgage-backed securities analytical systems. He is an accredited investor as defined in Regulation D under the Securities Act of 1933, as amended.
- (5) "E", the director of marketing for "O", who has twenty-three years of experience in the capital markets and a bachelor's degree in economics. "E" formerly was the director of marketing at "T" and a vice president at "U". He has passed the Series 3 and Series 7 examinations and is in the process of registering as an AP of "N" and "O".
- (6) "F", who is a quantitative analyst, systems administrator and chief programmer for "O". "F" formerly was a vice president at "P", where he was responsible for designing and encoding many of the analytic and structuring tools used by the CMO trading desk.
- (7) "G", the chief operating officer of "O", who is primarily responsible for day-to-day operations and clearing. "G" has passed the Series 7, 24 and 63 examinations and has a bachelor's degree in accounting. He formerly was responsible for various aspects of accounting, operations and compliance at "P".
- (8) "H", a member of "N", who is responsible for the design and implementation of computer systems and analytics. "H", who has a doctorate in mathematics, formerly was a senior vice president at "P", where he was in charge of

all fixed income quantitative research and was active in developing trading, accounting and portfolio valuation systems. He is an accredited investor under Regulation D.

- (9) "I", an "O" employee, who provides accounting, clearing and cash management services for the Fund and is actively involved in the origination of bridge financing for real estate loans. "I", who has passed the Series 3, 7 and 63 examinations, is "J's" brother.<sup>3/</sup> He formerly was a trader in "P"'s municipal bond department and oversaw the hedging and turnover of the department's inventory.

In support of your request, you represent that "by virtue of their positions, all of the [Non-QEP] Investors have ready access to information pertinent to an investment in" the Fund.

In addition, "N" wishes to permit another non-QEP investor, "K", "J's" father, to receive an assignment of a portion of the return that "J" receives on his investment in the Fund.<sup>4/</sup> The Agreement states that "W" assigns, as of January 1, 1996, to "K" an economic interest in "W"'s investment account attributable to the Fund equal to \$100,000.<sup>5/</sup>

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<sup>3/</sup> "J" formed the Fund with "V", a non-managing member of "N", and five other investment professionals who are managing members of "N" ("Managers"): "AA", "BB", "CC", "D" and "H". A company controlled by "J", "W", serves as the managing member of "N". "J", "V" and the Managers own "O". Commission records show that "W", "V", "J", "AA" and "BB" are listed as principals of both "N" and "O". "J", "AA", "BB" and "CC" are registered as APs of "N" and "O".

<sup>4/</sup> You provided a copy of the Assignment Agreement ("Agreement") and a portion of "N's" Limited Liability Company Operating Agreement ("Operating Agreement") by facsimiles transmitted on July 24 and July 25, 1996, respectively.

<sup>5/</sup> The Agreement states that the assignment shall be governed by and subject to all of the terms and conditions of the Operating Agreement and any subsequent amendments. The Operating Agreement defines "economic interest" as a "Member's rights to share in profits, losses and distributions of ["N"] and to receive interim and liquidating distributions and withdrawals from ["N"] in respect of the balances from time to time in such Member's Capital Accounts, and no other rights or entitlement of such Member." Accordingly, it does not grant "K" membership or  
(continued...)

Based upon your representations, 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 take any enforcement action against "N" for failure to comply with Rule 4.7(a) if it continues to claim relief pursuant to Rule 4.7, notwithstanding investment by the Non-QEP Investors in the Fund and assignment of an economic interest to "K", and treats the Non-QEP Investors as QEPs. This relief is, however, subject to the condition that each Non-QEP Investor consents in writing to being treated as a QEP.<sup>6/</sup>

We note that this letter relieves "N" solely from compliance with certain requirements of Rule 4.7 and does not excuse it from compliance with any other applicable requirements contained in the Commodity Exchange Act ("Act")<sup>7/</sup> or the Commission's regulations issued thereunder. For example, it remains<sup>8/</sup> subject to the antifraud provisions of Section 40 of the Act,<sup>8/</sup> 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. Further, this letter is applicable to "N" solely in connection with its operation of the Fund.

This letter is based upon the representations you have made to us and is subject to compliance with the condition stated above. 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 the Fund, including the composition of its investors, change in any way from those as represented to us. This letter represents the position of the

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<sup>5/</sup> (...continued)

any rights of membership in "N" or any portion of the incentive compensation received by members of "N".

<sup>6/</sup> You also have requested relief from Rule 4.7 such that "N" may treat as QEPs any investment or operations personnel who are hired by "O" in the future for positions that would afford access to information pertinent to investing in the Fund, provided that they have qualifications "substantially similar" to the Non-QEP Investors. As you know, the Division considers requests for relief from the requirements of Rule 4.7 on a case-by-case basis. Accordingly, "N" should request any such relief in writing at such time as it can provide specific information pertinent to its request.

<sup>7/</sup> 7 U.S.C. § 1 et seq. (1994).

<sup>8/</sup> 7 U.S.C. § 60 (1994).

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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 Natalie A. Markman, an attorney on my staff, at (202) 418-5450.

Very truly yours,

Susan C. Ervin  
Chief Counsel