CFTC Letter No. 97-60

July 1, 1997

Division of Trading & Markets

Re: Request for Relief from CPO Registration Requirement of Section 4m(1) of the Act; Request for Relief from the QEP Criteria of Rule 4.7(a)

Dear :

This is in response to your letter dated May 22, 1997 to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by your facsimile dated June 18, 1997 and by telephone conversations with Division staff. By your correspondence, you request that the Division not recommend that the Commission take any enforcement action against: (1) "N" for failure to comply with the commodity pool operator ("CPO") registration requirements of Section 4m(1) of the Commodity Exchange Act ("Act")[1] in connection with serving as the sole general partner of Fund I and Fund II, both of which are organized and operated in the United States ("U.S.") and for which relief has been claimed pursuant to Rule 4.7(a)[2]; and (2) "O", a registered commodity pool operator, for failure to comply with the "qualified eligible participant" ("QEP") criteria of Rule 4.7(a) in connection with serving as the CPO of Fund I, Fund II, and Fund III, which is not organized and operated in the U.S.

Based upon the representations made in your correspondence, we understand the relevant facts to be as follows. "O" will serve as the commodity trading advisor ("CTA") to Funds I and II, each of which is a Delaware limited partnership, and you request that it also be deemed to be the CPO of these funds. "O" also will serve as the CTA to Fund III, a Cayman Islands company, which will be operated as a Rule 4.7(a) exempt pool.[3] "P" and "Q" (the "Directors"), each of whom is a U.S. resident, will serve as members of the board of directors of Fund III.[4] These Directors comprise a minority of the members of the board of directors of Fund III.[5] "P" and "Q" are listed as principals of "O". In addition, "P" is registered as an associated person ("AP") of "O". Funds I, II and III invest in a variety of securities and other financial instruments issued by U.S. and foreign issuers and they may trade commodity interests. The current minimum investment for Funds I, II and III is $1,000,000, 5,000,000, and $1,000,000, respectively, subject to the discretion of each Fund's general partner or board of directors.[6]

Since "N" will be serving as the general partner of Funds I and II, it would, absent relief, be required to be registered as a CPO in connection with its operation of each such fund.[7] You

propose that with respect to Funds I and II, "O" be considered to be these funds' CPO, notwithstanding that "N" is the general partner of these funds. In support of this request, you represent that (1) "O" is registered as a CPO; (2) "O" and "N" are affiliated companies in that over 96% of the ownership interest in "O" is held by persons who also hold 98% of the ownership interest in "N";[8] (3) the holders of a majority of the ownership interest in "N" will be either registered as an AP or listed as a principal of "O" in that "P" is and will remain registered as an AP of "O" and "P" and "Q" are and will remain listed as principals of "O"; and (4) "N" will not engage in any activity that could subject it to regulation as a CPO other than serving as a general partner of Funds I and II.[9] You have enclosed with your letter a signed acknowledgment, dated May 22, 1997, whereby "O" and "N" agree to be jointly and severally liable with each other for any violations of the Act and Commission regulations thereunder applicable to CPOs in connection with the operation of Funds I, II and III.[10]

Based upon the foregoing, the Division will not recommend that the Commission take any enforcement action against "N" solely on the basis of its failure to register as a CPO pursuant to Section 4m(1) of the Act in connection with its serving as the general partner of Funds I and II. This position is, however, subject to the following conditions: (1) "O" will serve as the CPO of Funds I and II and will remain registered as a CPO; and (2) "N" will not exercise discretion, supervision, or control over or participate in: (i) the solicitation, acceptance or receipt of funds or property to be used for purchasing interests in Funds I and II[11] or (ii) the investment, use or other disposition of funds or property of Funds I and II.

As noted above, "O" also seeks relief from the QEP criteria of Rule 4.7(a) with respect to investments in Funds I, II and III by six proposed investors who constitute the Non-QEPs. With regard to five of the Non-QEPs, by letters dated May 5, 1995 and June 14, 1996, the Division granted no-action relief from compliance with the QEP criteria of Rule 4.7(a) to "O" such that these five Non-QEPs could invest in the funds described in those letters.[12] In support of the instant request that these six Non-QEPs be permitted to invest in Funds I, II and III, you represent that there have been no material changes with respect to the representations concerning these Non-QEPs made in your correspondence and as stated in our May 5, 1995 and June 14, 1996 letters, which are hereby incorporated by reference.

The sixth person for whom you seek QEP treatment is "X", who has been a Vice President of "O" since June 1996. "X" is in charge of financial due diligence functions with respect to new and existing investments of the various funds managed or advised by "O". "X" also monitors the financial performance and progress of such investments. From January 1995 to June 1996, "X" was employed by G as an analyst in its financial institutions group; from January 1993 to December 1994, "X" was employed by "Y" as a senior financial analyst in the investment banking division; and from August 1988 to December 1992, "X" was employed by "Z" as an audit manager. "X" has a B.S. in accounting and is a certified public accountant. You represent that although "X" is not an accredited investor, "his level of sophistication and responsibility vis-à-vis the Funds allow him to be a suitable investor in the Funds."

Based upon the foregoing, the Division will not recommend that the Commission take any enforcement action against "O" for its failure to comply with the QEP criteria of Rule 4.7(a) based solely upon its admission of the five Non-QEPs referred to in the Division's letters of May 5, 1995 and June 14, 1996 and "X" into Funds I, II and III. This position is, however, subject to the conditions that each Non-QEP: (1) consents in writing to being treated as a QEP for the purpose of investing in Funds I, II and III; and (2) has immediate access to the trading and other records of Funds I, II and III in which he seeks to invest.

This letter is based on the representations made in your correspondence and is subject to compliance with the conditions set forth above. Any different, changed or omitted facts or circumstances, for example, the creation of additional funds,[13] might require us to reach a different conclusion. In this regard, we ask that you notify the Division immediately in the event the operations or activities of "N", "O", the Directors, or Funds I, II and III change in any way from those as represented to the Division.

We note that this letter is applicable to "O" and "N" solely in connection with the operation of Funds I, II and III. It does not excuse "O" or "N" from compliance with any other applicable requirements contained in the Act or in the Commission's regulations issued thereunder. For example, each remains subject to the antifraud provisions of Section 4o of the Act,[14] to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the Commission's regulations and to all other applicable provisions of Part 4. We note that the pool operator must provide material disclosures, including fee information, with respect to offerings pursuant to Rule 4.7(a).

This letter represents the views of this Division only and does not necessarily represent the views of the Commission or of any other office or division of the Commission. If you have any questions concerning this correspondence, please contact me or Monica S. Amparo, an attorney on my staff, at (202) 418-5450.

Very truly yours,

Susan C. Ervin

Chief Counsel

[1] 7 U.S.C. §6m(1) (1994).

[2] "O" filed Notices of Claim for Exemption pursuant to Rule 4.7(a) on behalf of Fund I and Fund II, which were effective April 14, 1997 and May 12, 1997, respectively. Commission rules referred to herein are found at 17 C.F.R. Ch. I (1996).

[3] "O" filed a Notice of Claim for Exemption pursuant to Rule 4.7(a) on behalf of Fund III, which was

effective May 27, 1997. Fund III will have as participants persons who are not "U.S. persons," as that term is defined in Rule 4.7(a), tax-exempt U.S. persons who are QEPs under Rule 4.7(a), and certain Non-QEPs as described below in this letter ("Non-QEPs"). You explain that there is a tax advantage for U.S. tax-exempt investors to invest through an offshore corporate vehicle, such as Fund III, because such investors are not required to recognize "unrelated business taxable income" from investments in offshore corporate vehicles. The Division takes no position concerning the validity or effect of the structures described under U.S. internal revenue laws or any other legal requirements other than those specifically addressed herein. Further, the Division notes that the CPO of a pool operated pursuant to Rule 4.7(a) remains subject to the requirement in Rule 4.24(w) to "disclose all material information" and to statutory and regulatory antifraud prohibitions.

[4] It does not appear necessary for the Directors to request CPO registration relief in connection with Fund III inasmuch as: (1) they are listed as principals of "O"; and (2) the only U.S. persons who may invest in Fund III are U.S. tax-exempt entities who satisfy the eligibility criteria of Rule 4.7(a) and the Non-QEPs, who are either principals of "O" or its affiliate, "R". See CFTC Interpretative Letter No. 92-3, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,221 (Feb. 3, 1992) and CFTC Interpretative Letter No. 94-65, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,154 (June 22, 1994) (CPO registration relief for Board of Directors of a Rule 4.7(a) offshore fund which included certain tax-exempt U.S. persons meeting the eligibility criteria of Rule 4.7(a)).

[5] The majority of the members of the board of directors of Fund III are non-U.S. citizens and residents who are unaffiliated with "N", "O" or any of their affiliates.

[6] However, this amount may be waived for the Non-QEPs described below.

[7] See, e.g., CFTC Staff Interpretative Letter No. 75-16, [1975-77 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,104 (October 15, 1975).

[8] Specifically, the ownership of these firms is as follows. "P" and "Q" each owns a 48.05% interest, and "S" owns a 3.9% interest, in "O". "P" and "Q" each owns a 49% interest, and other employees of "N" own a 2% interest, in "N".

[9] You have explained that the Directors are authorized to, and from time to time do, allocate their profits from "N" to other persons employed by "N" or an affiliated company. Such allocation does not affect the ownership of the firm as stated in note 8, above.

[10] Although Fund III is included in the above-referenced acknowledgment, we note that "N"'s sole role with regard to Fund III is that of investment manager. You represent that pursuant to the organizational documents, "N" has delegated this responsibility to "O".

[11] Thus, in the event that "P" seeks to engage in such activity, he must do so in his capacity as an AP of

"O". You have also explained that in furtherance of compliance with federal and state law (e.g., Delaware law), the general partners of a limited partnership (i.e., "N" with respect to Funds I and II) must exercise discretion, supervision and control over, and must participate in, the admission of new limited partners, to the extent of confirming their qualifications as accredited investors and having authority to refuse to accept any person as a limited partner. Compliance with the foregoing federal and state law provisions will not be deemed to be in conflict with condition (2).

[12] These Non-QEPs are: "T", "U", "S", "V", and "W".

[13] You have indicated in your correspondence that "N" may serve as the general partner and/or investment manager for other funds which may be formed in the future. However, in general, Commission staff letters consider only the specific matters presented and, accordingly, this letter is limited to the three funds identified above. You should consult the Division for further guidance at the time that the creation of additional funds is contemplated.

[14] 7 U.S.C. §6o (1994).