CFTC Letter No. 98-63

August 17, 1998

Division of Trading & Markets

Re: Rule 4.7(a) -- Request for Exemption to Allow a CPO of a Rule 4.7(a) Exempt Pool to Treat an Employee Partnership as a Qualified EligibleParticipant;

Rules 4.21, 4.22, 4.23(a)(3), 4.23(a)(10) and (a)(11) -- Request for Exemption from CPO Disclosure, Reporting and Recordkeeping Requirements with respect to the Operation of an Employee Partnership

Dear :

This is in response to your letter dated March 24, 1998, to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by your letters dated April 8, 1998, April 30, 1998 and July 9, 1998 and telephone conversations with Division staff. By your correspondence, you request on behalf of "A", a registered commodity pool operator ("CPO") and commodity trading advisor ("CTA"), an exemption from Rule 4.7(a)[1] such that "A" may continue to claim relief pursuant to Rule 4.7(a) in connection with its operation of the Fund,[2] a pool for which "A" serves as the CPO and CTA, if it admits the Partnership, which is not a qualified eligible participant ("QEP") as that term is defined in Rule 4.7(a), as an investor in the Fund and treats the Partnership as if it were a QEP.[3] In addition, you request relief from the restriction in Rule 4.7(a)(1)(ii)(B)(*2*)(*xi*) (the "Ten Percent Restriction"), which would prevent the Partnership, as a pool with non-QEP participants, from investing more than ten percent of its assets in the Fund. Finally, you request on behalf of the managing general partner of the Partnership an exemption from the disclosure requirements of Rule 4.21, the reporting requirements of Rule 4.22 and the recordkeeping requirements of Rules 4.23(a)(3), 4.23 (a)(10) and (a)(11) in connection with his operation of the Partnership.[4]

Based upon the representations contained in your correspondence, we understand the facts to be as follows. The Partnership is a general partnership that was formed in March 1998. It has not yet begun to operate. The Partnership plans to invest solely in the Fund. "B", a registered CPO and CTA and the sole owner and a listed principal of "A", will serve as the CPO, CTA and managing general partner of the Partnership. "B" is a QEP. Participation in the Partnership is limited to "B" and the following senior-level employees of "A" (the "Partners"):[5]

(1) "C", who is the President and a registered Associated Person ("AP") of "A". In addition, "C" is registered as a sole proprietor CTA and is the sister of "B". "C" has been the President of "A" since December 1996. In this capacity, "C" oversees all operational, administrative and business development areas of the firm. "C" holds a Bachelor's degree in Mathematics and a computer science certificate from

"D". She was an administrative assistant dealing with trade resolution and client services at the investment firm of "E" from 1986 until 1989. She joined "A"'s predecessor, "B", sole proprietor CTA, in August 1994. "C"'s joint net worth with her spouse is $300,000. In addition, "C" has successfully completed both the National Commodities Futures ("Series 3") and the General Securities Representative ("Series 7") examinations, although she is no longer a registered representative.

(2) "F", who is the Controller of "A". In addition, "F" is the brother-in-law of "B". "F" is responsible for maintaining all the accounts of "A" and its pools, for selecting the Fund's administrator and cash manager and for implementing a system of cash management for each fund operated by "A". "F" holds both a Bachelor's and Master's degree in Accounting and a Bachelor's degree in Information Sciences from "D" and has substantial accounting experience. He was an auditor for the accounting firm of "G" from 1985 until 1986 and the Controller of the disposal firm of "H" from 1986 until joining "A" in February 1996. In addition, "F" is a certified management accountant and has obtained his Certificate in Financial Management. "F"'s joint net worth with his spouse is $700,000.

(3) "I", who is the Director of Marketing and a registered AP of "A". "I" is responsible for all communications on behalf of "A" with potential and existing investors. "I" holds a Bachelor's degree in Accounting from "D" and a Master's degree in Business Administration from "J". He was a salesman dealing in managed futures programs for the investment firm of "K" from 1986 until 1991, a government bond trader on the institutional trading desk for the investment firm of "E" from 1992 until 1996 and an independent futures trader from 1996 until joining "A" in September 1997. "I" had an income of approximately $100,000 in 1997 and a net worth of $250,000. In addition, "I" has successfully completed the Series 3, the Investment Company Products/Variable Contracts Limited Representative ("Series 6"), the Series 7 and the Uniform Securities Agent State Law ("Series 63") examinations.

(4) "L", who is the General Counsel of "A". "L" is responsible for all legal, compliance and regulatory matters addressed by "A". "L" holds a Bachelor's degree in Journalism from the "M" and a law degree from "N". Prior to joining "A", "L" was a trading advisory consultant and a Senior Editor for "O" from 1986 until 1990, a law student from 1990 until 1993 and an attorney specializing in commodities and securities law with the law firms of "P" from 1993 until 1994, "Q" from 1994 until 1996 and "R" from 1996 until joining "A" in November 1997. "L" had a joint income with his spouse of approximately $148,000 in 1997 and a projected income of $160,000 in 1998. In addition, "L" successfully completed the Series 3 examination in 1989 and was registered as a sole proprietor CTA, although he terminated this registration in 1993. "L" intends on retaking the Series 3 examination and registering as an AP of "A" in the near future.

Participation in the Partnership is voluntary and not a condition of continued employment with "A". The Partners will not be permitted to contribute more than fifteen percent of their annual income from "A" nor will they be permitted to contribute more than twenty percent of their total net worth to the Partnership. If a Partner leaves the employment of "A", his contribution will automatically be withdrawn from the Partnership, and a corresponding amount will be redeemed from the Fund at the end of that current month. The Partnership will not charge the Partners any fees or expenses derived from the operation of the Partnership, other than a pro-rata share of certain accounting and tax preparation expenses incurred by the Partnership. Any fees or expenses charged by the Fund will be distributed on a pro-rata basis to each investor in the Fund, including the Partnership. The Partnership will provide each Partner with an "Information Summary" describing all restrictions and risks associated with the Partnership, along with a Partnership subscription form prior to accepting the initial subscription from a Partner. The Partnership will also provide each Partner with Schedules K-1 and annual financial statements of the Partnership. In support of your request, you represent that each Partner consents to being treated as a QEP and further, that each Partner has access to all of the books and records pertinent to an investment in the Fund.

Because (1) the Partnership does not have total assets in excess of $5 million, (2) the Partnership is being formed for the purpose of investing in a Rule 4.7(a) exempt pool, and (3) other than "B", no Partner is a QEP, absent relief "A" may not admit the Partnership into the Fund and continue to operate the Fund under Rule 4.7(a).[6]

In addition, the Partnership wishes to invest more than ten percent of its assets in the Fund. Rule 4.7(a)(1)(ii)(B)*(2)(xi)* provides that "except where the pool . . . would constitute a qualified eligible participant under paragraph (a)(1)(ii)(D) of [Rule 4.7], no more than 10 percent of the fair market value of the assets of such entity are used to purchase units in exempt pools." Rule 4.7 (a)(1)(ii)(D) defines as a QEP "an entity in which all of the unit owners or participants are persons listed in paragraphs (a)(1)(ii)(A) or (a)(1)(ii)(B) of [Rule 4.7]." You assert that if the Division permits "A" to treat the Partners as if they satisfy the QEP criteria for purposes of investing in the Fund, then "A" also should be permitted to treat them as QEPs under Rule 4.7(a) (1)(ii)(D). Since the Partnership's status as a QEP would then be based on Rule 4.7(a)(1)(ii)(D), and not Rule 4.7(a)(1)(ii)(B)*(2)(xi)*, the Ten Percent Limitation would not be implicated.

Based upon the foregoing, it appears that granting the requested relief would not be contrary to the public interest and the purposes of Rules 4.7(a), 4.21, 4.22, 4.23(a)(3), 4.23(a)(10) and (a) (11).[7] Accordingly, by the authority delegated to it under Rule 140.93(a)(1), the Division hereby grants: (1) "A" an exemption such that it may treat the Partners as QEPs and continue to claim relief pursuant to Rule 4.7(a) notwithstanding the Partnership's investment in the Fund; (2) "A" an exemption such that it may treat the Partners as QEPs for purposes of qualifying the Partnership itself as a QEP under Rule 4.7(a)(1)(ii)(D); and (3) "B" an exemption from compliance with Rules 4.21, 4.22, 4.23(a)(3), 4.23(a)(10) and (a)(11) in connection with the operation of the Partnership.[8]

The exemptions granted by this letter do not excuse "A" or "B" from compliance with any

otherwise applicable requirements contained in the Commodity Exchange Act (the "Act")[9] or in the Commission's regulations issued thereunder. For example, each remains subject to all antifraud provisions of the Act and the Commission's regulations, to the reporting requirements for traders set forth in Parts 15, 18, and 19 and to all other provisions of Part 4. Moreover, these exemptions are applicable to "A" and "B" solely in connection with the operation of the Fund and Partnership, respectively, as discussed above.

This letter, and the exemptions granted herein, are based upon the representations you have made to us. Any different, changed or omitted material facts or circumstances might render these exemptions void. You must notify us immediately in the event the operations or activities of "A", "B", the Partnership or the Fund, including the composition of the Partnership's or Fund's investors, change in any material way from those as represented to us.

If you have any questions concerning this correspondence, please contact Charles O'Brien, an attorney on my staff, at (202) 418-5450.

Sincerely,

I. Michael
Greenberger

Director

[1] Commission rules referred to herein are found at 17 C.F.R. Ch. I (1998).

[2] "A" filed a Notice of Claim for Exemption pursuant to Rule 4.7(a) on behalf of the Fund on November 25, 1997.

[3] By your March 24, 1998 letter, you requested that the "Division not recommend action against the Partnership if it does not file a [Notice of Claim for Exemption pursuant to Rule 4.7(a)] and comply with the specific requirements of Rule 4.7(a)." Pursuant to discussions held with Division staff, by your letters dated April 30, 1998 and July 9, 1998, you revised your request so that you now seek an exemption on behalf of "B" from the disclosure, reporting and recordkeeping requirements of Commission Rules 4.21, 4.22, 4.23(a)(3), 4.23 (a)(10) and (a)(11) in connection with his operation of the Partnership.

[4] By your April 30, 1998 letter, you made an additional request that no Partner be required to register as a CPO. In light of the exemption provided by this letter, it has not been necessary for the Division to consider separately your request that the Division provide the Partners with a no-action position regarding their requirement to register as a CPO.

[5] Other than "B", none of the Partners qualifies as a QEP.

[6] *See* Rule 4.7(a)(1)(ii)(B)(*2*)(*xi*), which sets forth the criteria that a pool must satisfy to qualify as a QEP.

[7] Rule 4.23(a)(3) requires CPOs to maintain the Disclosure Document acknowledgement specified in Rule 4.21. Rules 4.23(a)(10) and (a)(11) require CPOs to prepare certain financial statements that support the periodic financial reports required by Rule 4.22(a). Inasmuch as we are granting "B" an exemption from Rules 4.21 and 4.22, we are also granting him an exemption from Rules 4.23(a)(3), 4.23(a)(10) and (a)(11). You have not provided us with any reason why "B" cannot or should not comply with the other requirements of Rule 4.23 and, accordingly, we are declining to provide further exemptive relief from that rule.

[8] *See, e.g.*, C.F.T.C. Interpretative Letter No. 97-86, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,183 (September 15, 1997); *See also, e.g.*, C.F.T.C. Interpretative Letter No. 96-6, [1994-96 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,608 (December 11, 1995).

[9] 7 U.S.C. § 1 *et seq.* (1994).