



U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5000

Market Participants
Division

Amanda L. Olear
Director

Philip T. Hinkle
Dechert LLP
1900 K Street, NW
Washington, DC 20006-1110

RE: Exemptive Relief Permitting Two Sigma Investments, LP to Treat Certain Employees as “Qualified Eligible Persons”

Dear Mr. Hinkle:

This letter is in response to your request dated October 9, 2023 to the Market Participants Division (“Division” or “MPD”) of the Commodity Futures Trading Commission (“Commission” or “CFTC”), as supplemented by subsequent communications with MPD staff (the “Correspondence”). In the Correspondence, you request an exemptive letter on behalf of Two Sigma Investments, LP (“Two Sigma Investments” and, collectively with its affiliates, “Two Sigma”), a registered commodity pool operator (“CPO”), in connection with certain commodity pools it currently operates as “employees’ securities companies,” pursuant to Sections 2(a)(13) and (6)(b) of the Investment Company Act of 1940, as amended (“40 Act”),¹ as well as 40 Act Rule 6b-1 (each such entity, an “ESC” and together, the “ESCs”).² Specifically, you request exemptive relief from the conditions by which certain Two Sigma employees may be considered “Qualified Eligible Persons” (“QEP”) under Regulation 4.7(a)(2)(viii)(A)(4) (the “QEP Tenure Conditions”).³

Based on the Correspondence, the Division understands the relevant facts to be as follows. You state that the purpose of this exemptive relief would be to permit Two Sigma to continue operating the ESCs pursuant to Regulation 4.7, while also accepting investments from certain senior employees (the “Modeling and Engineering Officers”) who do not currently meet the QEP

¹ 15 U.S.C. 80a-2(a)(13) and 80a-6(b); the 40 Act in its entirety may be found at 15 U.S.C. 80a-1-80a-64.

² 17 CFR 270.6b-1 (“Any employees’ securities company which files an application for an order of exemption under section 6(b) of the [40 Act] shall be exempt, pending final determination of such application by the [U.S. Securities and Exchange] Commission, from all provisions of the [40] Act applicable to investment companies as such”).

³ 17 CFR 4.7(a)(2)(viii)(A)(4). All CFTC regulations referred to herein are found at 17 CFR Ch. I (2022), and particularly, 17 CFR pt. 4.

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Tenure Conditions. In short, you argue that although these Modeling and Engineering Officers may not technically meet the QEP Tenure Conditions, they do possess advanced education, other prior work experience, and deep knowledge of Two Sigma's operations and trading activities such that considering them QEPs, for the limited purpose of investing in the ESCs, is appropriate. You claim further that these individuals have a thorough understanding of the operations and trading of Two Sigma and the ESCs, and therefore, they can competently assess the risks and rewards of participating therein, in a manner similar to other QEPs. Finally, you state in support of your request that considering these Modeling and Engineering Officers QEPs and thus permitting their investment in the ESCs, as described further below, would not be contrary to the public interest or the purposes of Regulation 4.7.

In the Correspondence, you describe Two Sigma as a quantitative investment management firm with approximately \$59.9 billion in assets under discretionary management across Two Sigma and its affiliates, as of October 1, 2023. Because of the quantitative strategy and process employed in making its investment decisions, you state that Two Sigma recruits heavily from the technology industry, particularly for its "Modeling and Engineering" division. You describe Two Sigma's Modeling and Engineering division as responsible for a variety of critical activities and as comprising the majority of Two Sigma's research and development personnel. For instance, you state that the Modeling and Engineering Officers currently perform a variety of tasks and functions that are routine duties of financial services sector employees and that are critical to Two Sigma's operations, like equities and macro research, portfolio management, trading, trading engineering, modeling engineering, and data engineering. As part of Two Sigma's recruitment and retention of employees, you explain further that Two Sigma sought to offer investment programs competitive with those provided at other comparable investment managers. In 2020, the U.S. Securities and Exchange Commission ("SEC") issued an exemptive order pursuant to Sections 6(b) and 6(e) of the 40 Act permitting Two Sigma to offer and operate an employee investment vehicle as an ESC.⁴ Two Sigma currently operates two ESCs pursuant to that order and may also form and operate additional ESCs in the future. You state further that the ESCs are operated in a funds-of-funds structure, in that they invest all or substantially all of their assets in various private investment vehicles also managed by Two Sigma, which are themselves operated pursuant to Regulations 4.7(b) or 4.13(a)(3).⁵

Because the ESCs invest in underlying commodity pools, or may themselves invest in commodity interests directly, you state that the ESCs are "pools" as defined in Regulation 4.10(d)(1), and that Two Sigma operates the ESCs pursuant to Regulation 4.7 in reliance upon the compliance relief provided by that provision.⁶ To date, you explain that, in accordance with

⁴ Investment Company Act Release No. 33846, available at <https://www.sec.gov/files/rules/ic/2020/ic-33846.pdf>. In the Correspondence, you explain that Rule 6b-1 of the 40 Act permitted Two Sigma's operation of the ESCs while the requested exemptive order was pending.

⁵ 17 CFR 4.7(b) (providing compliance exemptions to registered CPOs of commodity pools offered solely to individuals or entities considered QEPs as defined in Regulation 4.7(a)); 17 CFR 4.13(a)(3) (providing an exemption from CPO registration with respect to a pool, the commodity interest trading of which meets one of two *de minimis* thresholds stated therein).

⁶ 17 CFR 4.10(d)(1); 17 CFR 4.7.

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the requirements of Regulation 4.7, the ESCs have only admitted Two Sigma employees⁷ as investors who meet firm-specific seniority requirements and were at the time of investment: (a) “accredited investors,” as defined under Regulation D of the Securities Act of 1933, as amended (“Accredited Investors”), and (b) QEPs, as defined in Regulations 4.7(a)(2)-(3). Additionally, you state that participants in the ESCs receive from Two Sigma: (1) extensive offering materials comparable to materials Two Sigma provides to third-party investors in its externally-offered funds; (2) additional documentation regarding certain “Frequently Asked Questions” specifically regarding investment in the ESC; (3) audited financial statements prepared in accordance with Regulation 4.7(b)(4) on an annual basis; (4) monthly account statements prepared in accordance with Regulation 4.7(b)(3); and (5) access to additional reporting regarding the ESC.

The QEP Tenure Conditions found in Regulation 4.7(a)(2)(viii)(A)(4) generally limit QEP status to employees with specified amounts of prior financial services experience, and thus restrict which Two Sigma employees may participate in the ESCs.⁸ As a quantitative investment fund manager, you state that Two Sigma employs individuals who often have backgrounds working in technology-related fields outside of the traditional financial services sector. Despite the Modeling and Engineering Officers being deeply involved in the operation of Two Sigma and playing important roles in designing and implementing its trading strategies as described above, you state that several of them are ineligible to participate in the ESCs because their prior employment experience includes categories that do not count for purposes of the QEP Tenure Conditions, such as academia, computer science, and technology industries. Although these Modeling and Engineering Officers do not possess the traditional financial services background contemplated by the QEP Tenure Conditions, you confirm that they have extensive technology, business, and/or finance education and employment experience that inform and support their work at Two Sigma and that deepen their understanding of Two Sigma’s investment activities and processes.

In the Correspondence, Two Sigma requests an exemptive letter from MPD that would provide limited relief from the QEP Tenure Conditions in Regulation 4.7, such that Two Sigma may offer the ESCs to all of the Modeling and Engineering Officers it employs. You further explain that the uniform application of the QEP Tenure Conditions to the Modeling and Engineering Officers would, in this situation, produce different results for similarly situated personnel: some Modeling and Engineering Officers with relevant, but not financial services, experience, would remain ineligible to invest in the ESCs, despite their integral roles in Two Sigma, being Accredited Investors, and otherwise meeting the ESC’s seniority requirements; other individuals, however, even with the same role or job title, could be permitted to invest if their prior experience was gained with a financial services company. However, because many of the Modeling and Engineering Officers already have more than the 24 months of financial

⁷ In addition to eligible Two Sigma employees, you state that trusts or other vehicles organized by or for the benefit of such persons are also permitted investors in the ESCs.

⁸ 17 CFR 4.7(a)(2)(viii)(A)(4). Additionally, you state that Two Sigma’s seniority requirements further restrict the population eligible to invest in its ESCs, and as applied, would permit fewer than 20% of the Modeling and Engineering employees to participate, dependent on their individual QEP status.

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services experience required by the QEP Tenure Conditions (either at Two Sigma or from prior employment), you state that the requested relief would cover a specific subset of Modeling and Engineering Officers that have not been employed by Two Sigma or another financial services firm for a combined total of 24 months or longer. Therefore, you explain that Two Sigma's request pertains to fewer than 2.5% of Two Sigma's Modeling and Engineering population - those who are both Modeling and Engineering Officers and who have not worked at Two Sigma or another financial services firm for at least 24 months.

In support of your request, you state that staff of MPD's predecessor divisions have accommodated CPOs in similar situations when the facts and circumstances merited exemptive relief, and that the exemptive letter you request in the Correspondence is consistent with those past CFTC staff responses. You cite multiple instances where Commission staff previously issued letters permitting non-QEP employees to invest in commodity pools operated by their employer-CPOs pursuant to Regulation 4.7, based on their position in the CPO and their professional expertise.⁹ Although later amendments to Regulation 4.7 eliminated the need for many CPOs to seek exemptive relief for treating "knowledgeable employees" as QEPs, the Commission understood in 2000 that these regulatory changes would not cover every circumstance in which conferring QEP status to an employee might be appropriate, and reserved the right to further interpret its QEP definition as needed to effectuate the purposes of the Commodity Exchange Act ("CEA" or "Act") and Commission regulations.¹⁰

Regulation 4.7(b) provides an exemption from otherwise applicable Part 4 compliance requirements, including disclosures, reporting, and recordkeeping, to the claiming registered CPO with respect to commodity pools offered and sold solely to QEPs. Regulation 4.7 was adopted by the CFTC "as part of the Commission's ongoing program for review of its rules and in furtherance of its objectives of reducing unnecessary regulatory burdens and coordinating its rules with those of other regulators while maintaining effective customer protection."¹¹ In

⁹ CFTC Letter 94-01 (permitting a corporate and securities lawyer, who acted as engagement counsel for the CPO and pool and was also an accredited investor, to make additional investments after the CPO claimed a Regulation 4.7 exemption for the pool, notwithstanding that he was not a QEP, due to his lengthy legal career and involvement in the pool's formation); CFTC Letter 00-06 (permitting a CPO's Director of Information and Technology, who was responsible for software development for the CPO and pool and had built computer models based on his research in commodities pricing, to be considered a QEP); CFTC Letter 00-17 (permitting a CPO to operate its pools pursuant to Regulation 4.7 exemptions, notwithstanding the participation of non-QEP employees, two of whom had been employed by the CPO for less than 24 months); CFTC Letter 00-68 (permitting a CPO to treat several non-QEP employees, who included its Managing Members, Systems Manager, and Software Manager, as QEPs because they would be considered "knowledgeable employees" as defined by SEC regulations).

¹⁰ The Commission adopted amendments to Regulation 4.7 in 2000 that added "knowledgeable employees" as defined by certain SEC regulations as a category of individuals that could qualify as QEPs. 65 Fed. Reg. 47850, 47852 (Aug. 4, 2000), *citing* 65 Fed. Reg. 11253, 11259 (Mar. 2, 2000) ("The Commission has the right further to interpret or to amend Rule 4.7 to exclude from the QEP ...definition[] any person that the SEC or its staff found to be a ...knowledgeable employee or to include in the QEP ...definition[] any person the SEC or its staff excluded from the knowledgeable employee definition, if such action is found to be necessary to effectuate the purposes of the Act and the Commission's regulations. The Commission expects that it would exercise this right infrequently."). *See also* 17 CFR 4.7(a)(2)(vii).

¹¹ *See* Exemption for Commodity Pool Operators with Respect to Offerings to Qualified Eligible Participants;

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particular, the Commission sought to include in the QEP definition in Regulation 4.7(a) objective criteria by which a CPO could assess a potential participant's financial sophistication, acumen, and/or experience in trading commodity interests, as a proxy for determining their eligibility for and ability to understand complex commodity interest investment products.¹² An employee or agent of a CPO or its 4.7 exempt pool "engaged to perform legal, accounting, auditing or other financial services for, the exempt pool or the [CPO], commodity trading advisor or investment adviser of the exempt pool" may qualify as a QEP under Regulation 4.7(a)(2)(viii)(A)(4), if the employee or agent is an Accredited Investor and "has been employed or engaged by the exempt pool, [CPO], commodity trading advisor, investment adviser, or affiliate, or by another person engaged in providing commodity interest, securities or other financial services, for at least 24 months."¹³ Therefore, if a Two Sigma Modeling and Engineering Officer's previous employers were not "engaged in providing commodity interest, securities or other financial services," then that employment experience would not be counted toward the QEP Tenure Conditions, and this person could only be considered a QEP after their employment at Two Sigma spans a 24-month period.

Given the facts as represented by you in the Correspondence, applicable Commission regulations, and previously issued exemptive letters with respect to the QEP status of CPOs' employees, it is the Division's opinion that permitting a specific subset of Two Sigma's Modeling and Engineering Officers to be treated as QEPs appropriately recognizes their specific education and professional expertise, as well as their deep knowledge and involvement with respect to Two Sigma and the highly technical nature of its fund operations, as reasonably equivalent to the work experience required by the QEP Tenure Conditions. In reaching that conclusion, the Division notes certain particular facts from the Correspondence, specifically that the small number of individuals who would be covered by the requested exemptive letter 1) are limited to Two Sigma's Modeling and Engineering Officers who are also financially sophisticated Accredited Investors; 2) possess actual knowledge, familiarity, and significant involvement in Two Sigma's trading and fund operations; and 3) receive detailed ESC disclosures, as well as periodic and annual reporting that meet or exceed the requirements in Regulation 4.7, from Two Sigma. Moreover, this QEP treatment of certain Modeling and Engineering Officers would be temporary, in that, as soon as an individual officer gains the requisite 24 months of work experience with Two Sigma or a combination of employers engaged in financial services, that person can meet the QEP Tenure Conditions on their own and would no longer require exemptive relief to invest in Two Sigma's ESCs. In consideration of the foregoing, the Division concludes that your request is neither contrary to the purposes of Regulation 4.7 nor to the public interest, and is consistent with prior exemptive letters issued to other CPOs by predecessor Divisions, as discussed above.

Exemption for Commodity Trading Advisors with Respect to Qualified Eligible Client, 57 Fed. Reg. 34854 (Jan. 28, 1992). Regulation 4.7 was adopted, in part, to harmonize the Commission's Part 4 regulations with existing securities laws and regulations applicable to sophisticated investors, while also ensuring that market participants still receive customer protections necessary and appropriate for commodity interest investments.

¹² *Id.* at 34855.

¹³ 17 CFR 4.7(a)(2)(viii)(A)(4).

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Exemptive Relief Granted

Therefore, pursuant to the authority under Regulation 4.12(a), as delegated to the Division by the Commission under Regulation 140.93(a)(1), the Division hereby grants the requested exemptive relief to Two Sigma with respect to the ESCs operated as commodity pools pursuant to Regulation 4.7, subject to the following conditions:

1. The exemptive relief in this letter is limited to Two Sigma's Modeling and Engineering Officers, as well as trusts or other vehicles (organized for the benefit of such persons) meeting the conditions of Regulation 4.7(a)(2)(ix),¹⁴ who are Accredited Investors and able to meet the seniority and other conditions of Two Sigma's ESC Application and participation agreement.
2. Two Sigma will operate the ESCs in a manner consistent with Two Sigma's ESC Application approved by the SEC in 2020, and as described in the Correspondence.
3. Modeling & Engineering Officers participating in the ESCs are not permitted to sell, assign, or otherwise transfer their interests, in whole or in part, to any person without the prior written consent of such ESC's managing member. Any such sales, assignments or transfers are only permitted to other QEPs (including gifts, bequests, or transfers pursuant to legal separation, divorce, or death), to persons who may be considered QEPs by virtue of this exemptive relief, or to the ESCs, for purposes of redemption.
4. Participation in the ESCs is voluntary, and Two Sigma will obtain the consent of any non-QEP Modeling and Engineering Officers prior to treating them as QEPs as requested herein.
5. If an existing participant in the ESCs ceases to be an employee of Two Sigma, the exemptive relief provided in this letter will no longer apply to such person, and that person is not permitted to make additional ESC contributions.
6. Offering memoranda and Two Sigma's "Frequently Asked Questions" regarding the ESCs, as well as the periodic and annual reports specified in Regulations 4.7(b)(3) and (b)(4), are provided to all prospective and actual ESC participants. Copies of all of these promotional materials and reports must be maintained at Two Sigma's main business office in accordance with Regulations 1.31 and 4.7(b)(5).
7. Two Sigma will notify Division staff in the event that the operations of the ESCs materially change from the facts represented in the Correspondence.

¹⁴ 17 CFR 4.7(a)(2)(ix).

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This letter, and the exemptive relief herein, is based upon the representations that have been made to the Division, and is applicable solely to Two Sigma with respect to the operations of the ESCs. Any different, changed, or omitted facts or conditions might render this exemptive relief void. Moreover, this letter does not excuse Two Sigma from compliance with any other applicable requirements contained in the CEA or in the Commission's regulations issued thereunder. Finally, the Division also retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the exemptive relief provided herein in its discretion.

If you have any questions regarding this letter, please contact Pamela Geraghty, Deputy Director, at 202-418-5634 or pgeraghty@cftc.gov, Elizabeth Groover, Acting Associate Director, at 202-418-5985 or egroover@cftc.gov, or Peter Sanchez, Special Counsel, at 202-418-5237 or psanchez@cftc.gov.

Very truly yours,

Amanda L. Olear
Director
Market Participants Division

cc: Regina Thoele, Compliance
National Futures Association