

# CFTC Expands Statutory Disqualification to Exempt CPOs

June 11, 2020

On June 4, 2020, the Commodity Futures Trading Commission (the “CFTC”) adopted an amendment to CFTC Regulation 4.13 (as amended, the “Rule”) for exemption from commodity pool operator (“CPO”) registration. The Rule will require a person claiming such exemption to represent that neither it nor any of its principals has incurred any of the statutory disqualifications set out in Section 8a(2) of the Commodity Exchange Act (the “CEA”).<sup>1</sup> The amendment takes effect 60 days after publication in the Federal Register (the “Effective Date”).

A person initially claiming a CPO exemption pursuant to CFTC Regulation 4.13 on or after the Effective Date will need to comply with the Rule at the time of filing such claim. For a CPO currently relying on an exemption under CFTC Regulation 4.13 as of the Effective Date, the CFTC has determined not to mandate compliance until March 1, 2021, which coincides with the deadline for such CPO to file an annual reaffirmation notice for the exemption.

**Background.** Under the CEA, a CPO is required to register as such with the CFTC unless it qualifies for an exemption. CFTC Regulation 4.13 enumerates various exemptions from registration that are available to a CPO, including the *de minimis* exemption under Regulation 4.13(a)(3). The CFTC notes that a person seeking registration as a CPO, and its principals, are generally refused registration if they have disclosed or are found to have in their backgrounds one of the statutory disqualifications set forth in Section 8a(2) of the CEA (without the opportunity for a hearing) or in Section 8a(3) of the CEA (after the opportunity for a hearing).

Prior to the adoption of the amendment, however, a person claiming an exemption from CPO registration under CFTC Regulation 4.13 was not required to disclose any previous matters that might impact its eligibility or fitness for registration, or to otherwise meet any basic conduct standards beyond the substantive requirements for the claimed exemption. The CFTC notes that it had previously become aware of a

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<sup>1</sup> See CFTC Release No. 8173-20, “CFTC Unanimously Approves Final Rule at June 4 Open Meeting” (Jun 4, 2020), available at <https://cftc.gov/PressRoom/PressReleases/8173-20>.

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number of statutorily disqualified CPOs operating commodity pools pursuant to registration exemptions currently or formerly available under Regulation 4.13. The amendment is intended to close this “regulatory gap,” further enhance customer protection of exempt pool participants and generally promote the public interest.

**Covered Statutory Disqualifications.** Sections 8a(2) and 8a(3) of the CEA set forth a number of statutory disqualifications that apply with respect to a person seeking registration as a CPO and its principals. Whereas the violations addressed in Section 8a(3) require a formal hearing before barring the registration, those set forth in Section 8a(2) are more serious violations that will typically bar a registration without the requirement for a hearing.

For purposes of the representation required to be made by a person claiming a CPO exemption under CFTC Regulation 4.13, the CFTC has determined to limit coverage only to those statutory disqualifications enumerated in Section 8a(2) of the CEA (“Covered Statutory Disqualifications”). For ease of reference, we have included a list of the Covered Statutory Disqualifications, as currently in effect, at the end of this update.<sup>2</sup>

**Application to Principals.** The representation under the amended Rule applies to both a CPO and its principals. The CFTC acknowledges that a CPO seeking to claim or reaffirm an exemption under CFTC Regulation 4.13 may be required to devote time and resources to determining who in its organization is a principal and whether any of those principals have a Covered Statutory Disqualification in their background. However, the CFTC notes that the “principal” definition, generally speaking, is limited to those individuals and entities within the CPO who have either management authority and responsibilities, or significant power derived from stock ownership or capital contributions. This typically includes managing members, company presidents, corporate executives, chief compliance officers, any individual who (directly or indirectly) is a 10% or more shareholder, any entity that (directly) is a 10% or more shareholder and similarly situated individuals and entities. The CFTC also notes that CFTC Regulation 3.1 details the roles, titles, ownership and responsibilities that can give rise to a person being a principal.

**Limited Exceptions.** A Family Office (as defined in CFTC Regulation 4.13(a)(6)) will not be required to make the new representation as to absence of Covered Statutory Disqualifications. The CFTC indicates that, since such a Family Office only serves “family clients,” it generally poses little customer protection risk to the investing public.

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<sup>2</sup> Although the Covered Statutory Disqualifications under Section 8a(2) of the CEA are detailed in nature, there are sometimes interpretive questions that are not readily addressed in the statutory language. For example, non-U.S. jurisdictions do not always distinguish between felonies and misdemeanors as is the case with U.S. laws.

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Additionally, an exception is provided for Covered Statutory Disqualifications that have previously been disclosed by the person or its principal in prior registration applications that were approved by the CFTC. This could apply, for example, where a registered CPO that has previously disclosed Covered Statutory Disqualifications in connection with its prior registration application submitted to the CFTC is claiming a CPO exemption with respect to the operation of a particular pool.

**Exemptive Relief.** A person who has a Covered Statutory Disqualification, but believes it should not negatively affect its ability to claim a CPO exemption, may seek (on an individual or firm-by-firm basis) exemptive letter relief from the CFTC. Any such request for exemptive letter relief should present the facts and legal rationale demonstrating that the granting of such relief would be consistent with the public interest and not contrary to the customer protection purposes of the amended Rule. The CFTC notes, however, that it expects to grant an exemptive letter infrequently only when supported by a strong factual and legal basis.

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Please do not hesitate to contact us with any questions.

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**Annex—List of Covered Statutory Disqualifications:** A person seeking an exemption, or a principal of any such person, will be deemed subject to a Covered Statutory Disqualification (as set forth in Section 8a(2) of the CEA) if:

(A) a prior registration of such person in any capacity [with the CFTC] has been suspended (and the period of such suspension has not expired) or has been revoked;

(B) registration of such person in any capacity [with the CFTC] has been refused under the provisions of [Section 8a(3) of the CEA] within five years preceding the filing of the application for registration or at any time thereafter;

(C) such person is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction,... including an order entered pursuant to an agreement of settlement to which the [CFTC] or any Federal or State agency or other governmental body is a party, from (i) acting as a futures commission merchant, introducing broker, floor broker, floor trader, commodity trading advisor, commodity pool operator, associated person of any registrant [with the CFTC], securities broker, securities dealer, municipal securities broker, municipal securities dealer, transfer agent, clearing agency, securities information processor, investment adviser, investment company, or affiliated person or employee of any of the foregoing or (ii) engaging in or continuing any activity where such activity involves embezzlement, theft, extortion, fraud, fraudulent conversion, misappropriation of funds, securities or property, forgery, counterfeiting, false pretenses, bribery, gambling, or any transaction in or advice concerning contracts of sale of a commodity for future delivery, concerning matters subject to [CFTC] regulation under section 6c or 23 of [the CEA], or concerning securities;

(D) such person has been convicted within ten years preceding the filing... or at any time thereafter of any felony that (i) involves any transactions or advice concerning any contract of sale of a commodity for future delivery, or any activity subject to CFTC regulation under section 6c or 23 of [the CEA], or concerning a security, (ii) arises out of the conduct of the business of a futures commission merchant, introducing broker, floor broker, floor trader, commodity trading advisor, commodity pool operator, associated person of any registrant under [the CEA], securities broker, securities dealer, municipal securities broker, municipal securities dealer, transfer agent, clearing agency, securities information processor, investment adviser, investment company, or an affiliated person or employee of any of the foregoing, (iii) involves embezzlement, theft, extortion, fraud, fraudulent conversion, misappropriation of funds, securities or property, forgery, counterfeiting, false pretenses, bribery, or gambling, or (iv) involves the violation of section 152, 1001, 1341, 1342, 1343, 1503, 1623, 1961, 1962, 1963, or 2314, or chapter 25, 47, 95, or 96 of title 18 [of the U.S. Code], or section 7201 or 7206 of title 26 [of the U.S. Code];

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(E) such person, within ten years preceding the filing... or at any time thereafter, has been found in a proceeding brought by the [CFTC] or any Federal or State agency or other governmental body, or by agreement of settlement to which the [CFTC] or any Federal or State agency or other governmental body is a party, (i) to have violated any provision of [the CEA], the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Securities Investors Protection Act of 1970, the Foreign Corrupt Practices Act of 1977, chapter 96 of title 18 [of the U.S. Code], or any similar statute of a State or foreign jurisdiction, or any rule, regulation, or order under any such statutes, or the rules of the Municipal Securities Rulemaking Board where such violation involves embezzlement, theft, extortion, fraud, fraudulent conversion, misappropriation of funds, securities or property, forgery, counterfeiting, false pretenses, bribery, or gambling, or (ii) to have willfully aided, abetted, counseled, commanded, induced, or procured such violation by any other person;

(F) such person is subject to an outstanding order of the [CFTC] denying privileges on any registered entity to such person, denying, suspending, or revoking such person's membership in any registered entity or registered futures association, or barring or suspending such person from being associated with a registrant under [the CEA] or with a member of a registered entity or with a member of a registered futures association; or

(G) as to any of the matters set forth in [Section 8a(2) and Section 8a(3) of the CEA], such person willfully made any materially false or misleading statement or omitted to state any material fact in such person's application [for registration with the CFTC] or any update thereto.