

CFTC Proposes Rules to Streamline Certain CPO and CTA Regulations

November 19, 2018

On October 9, 2018, the Commodity Futures Trading Commission (the “CFTC”) issued proposed rules (the “Proposed Rules”)¹ to simplify regulations for commodity pool operators (“CPOs”) and commodity trading advisors (“CTAs”).

The Proposed Rules would codify several CFTC staff letters under Part 4 of the CFTC regulations. If adopted, the Proposed Rules would, among other things:

- Permit a CPO that solicits and/or accepts funds from non-U.S. persons for participation in an offshore commodity pool that does not permit U.S. participants to claim an exemption from CPO registration with respect to such pool regardless of the level of commodity interest trading activities of such pool and regardless of whether the CPO operates other pools that include U.S. participants;
- Permit a U.S.-based CPO of an offshore commodity pool with U.S. participants to maintain the commodity pool’s original books and records at the pool’s offshore location rather than at the CPO’s main U.S. business location;
- Prohibit a person that would be statutorily disqualified from registering as a CPO from claiming or affirming an exemption from CPO registration;
- Explicitly permit persons located outside the United States as pool participants in a commodity pool for which the CPO claims the *de minimis* exemption under CFTC regulation 4.13(a)(3) (the “CPO *de minimis* exemption”), regardless of their financial sophistication;
- Provide registration relief for CPOs and CTAs of entities qualifying as “Family Offices” and for investment advisers of business development companies;

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¹ The text of the CFTC Proposed Rules and the accompanying release are available at: <https://www.cftc.gov/PressRoom/PressReleases/7825-18>.

- Permit a qualifying CPO to engage in general solicitation in its pool offerings, as contemplated by the Jumpstart Our Business Start-ups Act of 2012 (the “JOBS Act”); and
- Relieve certain CPOs and CTAs of the requirement to file Forms CPO-PQR and CTA-PR.

Comments on the Proposed Rules are due by December 17, 2018.

Relief for a CPO Operating in Multiple Jurisdictions

Background

CFTC regulation 3.10(c)(3) grants an exemption from registration to a person located outside the United States that engages in the activity of a CPO in connection with any commodity interest transaction “only on behalf of persons located outside the United States, its territories or possessions” (subject to certain conditions). However, such exemption is not currently available where the CPO engages in such activities on behalf of any U.S. person, even if such U.S. person is in a separate pool from the non-U.S. pool participants.

CFTC Staff Advisory 18-96 permits a qualifying registered CPO operating offshore commodity pools to claim relief from certain disclosure, reporting and recordkeeping requirements with regard to its offshore commodity pools, subject to certain conditions. Advisory 18-96 also permits a qualifying registered CPO, as an alternative, to claim relief solely from the books and records location requirement in CFTC regulation 4.23, allowing such CPO to maintain its offshore pool’s original books and records at the pool’s offshore location, subject to certain conditions.

Proposed Amendments

The Proposed Rules would provide relief to certain CPOs that do not currently qualify for the relief provided by CFTC regulation 3.10(c)(3)² by adding a new exemption from CPO registration and would expand and incorporate both types of relief provided by Advisory 18-96 into Part 4 of the CFTC regulations.

- First, the Proposed Rules would amend CFTC regulation 4.13 to permit a CPO (including a U.S.-based CPO) that operates one or more pools with U.S. participants and also operates one or more offshore pools for which funds are solicited and/or

² The Proposed Rules would not amend or replace CFTC regulation 3.10(c)(3), which would continue to be available to a qualifying foreign CPO that complies with its requirements.

accepted solely from non-U.S. persons to claim an exemption from CPO registration with respect to such offshore pool(s), subject to conditions that are generally consistent with those currently set forth in Advisory 18-96 (except with respect to the requirement that the CPO claiming the exemption be registered as a CPO). This exemption (the “18-96 Exemption”) would, in effect, expand the relief currently available under Advisory 18-96 to provide more comprehensive relief from CPO registration,³ including relief from the requirement to file with the National Futures Association (the “NFA”) a Form CPO-PQR that includes the exempt offshore pool(s).⁴

- Eligibility for the exemption in respect of a particular pool would be subject to the conditions that: (1) the pool is (and remains) organized and operated outside the United States; (2) no meetings or administrative activities of the pool are held in the United States; (3) no pool participant is (or will be) a U.S. person; (4) no capital is contributed (directly or indirectly) from sources in the United States; and (5) the CPO, the pool and their respective affiliates do not engage in any marketing activity for the purpose (or that could reasonably be expected to have the effect) of soliciting participation in the pool by U.S. persons.
- This exemption would not be self-executing; rather, a CPO relying on this exemption would need to file a notice of exemption with the NFA, similar to the notice currently required for CPOs relying on the CPO *de minimis* exemption under CFTC regulation 4.13(a)(3). In this case, however, such notice would need to be filed within 30 days of engaging in CPO activities that would make relief under CFTC regulation 3.10(c)(3) unavailable to such person. Until that time, the person could freely rely on CFTC regulation 3.10(c)(3), which is self-executing. In other words, a non-U.S.-based CPO would have 30 days to claim this exemption with respect to a pool eligible for this exemption from the date it solicits or accepts investments from a U.S. person in another pool. With respect to such other pool, such CPO would either have to register as a CPO or claim a different exemption from registration requirements. Again, this does not imply that this exemption could be claimed only by a non-U.S.-based CPO.
- A CPO that is currently registered with the CFTC (with respect to a pool that would meet the requirements of this exemption) and intends to withdraw from

³ The CFTC notes that this amendment would pose only limited risk to participants in those pools requiring registration, as CPOs are already prohibited from commingling property of any commodity pool with the property of any other person, limiting the potential for an offshore pool’s losses to impact U.S. customers.

⁴ CFTC Advisory 18-96 is currently limited to registered CPOs and provides relief from certain disclosure, reporting and recordkeeping requirements, but not from the requirement of a registered CPO to file a Form CPO-PQR with the NFA (providing certain information regarding the CPO’s operations and each commodity pool it operates).

registration with respect to such pool in order to claim this exemption (or another exemption under CFTC regulation 4.13) would be required to provide written notice to such pool's participants that it intends to withdraw from registration and claim the exemption, and to provide each such participant with a right to redeem its interest in such pool prior to filing the notice of exemption with the NFA.

- A CPO claiming this exemption would remain subject to the anti-manipulation and anti-fraud provisions of the Commodity Exchange Act ("CEA"), and would be required to make and keep books and records for the exempt pool, and to submit to such special calls as the CFTC may make to demonstrate eligibility for and compliance with the exemption.
- As proposed, the requirement to furnish a written communication stating that the CPO is exempt from registration (and therefore is not required to deliver a disclosure document and a certified annual report to pool participants) would apply to a CPO relying on the 18-96 Exemption. In the release accompanying the Proposed Rules (the "Proposing Release"), the CFTC requests comment as to whether such requirement should apply to CPOs operating such offshore pools, because only non-U.S. persons would be participants in the qualifying pools operated by persons claiming the 18-96 Exemption and thus such communication might not be useful to such non-U.S. persons at all.
- Second, the Proposed Rules would amend CFTC regulation 4.23 to provide an exemption to a U.S.-based registered CPO from the requirement that the original books and records of its offshore commodity pool(s) be maintained at its main U.S. business office. This exemption would also not be self-executing; rather, a CPO would need to file a claim for exemptive relief with the NFA, signed by an authorized person of the CPO, making most of the same representations currently required for persons relying on the corresponding relief under Advisory 18-96, including that: (1) the CPO will maintain the original books and records of the offshore pool at the pool's main office outside the United States (and specifying such location and the contact information for the person with custody of such original books and records); (2) the CPO desires to maintain such books and records outside the United States to benefit from certain U.S. federal income tax treatment; (3) the CPO will maintain duplicate books and records of the offshore pool at a designated U.S. office; and (4) the original books and records will be provided within 72 hours of any request from the CFTC, NFA or Department of Justice.

Permitting Non-U.S. Pool Participants in *De Minimis* Pools

The Proposed Rules would amend the CPO *de minimis* exemption (under CFTC regulation 4.13) explicitly to permit participation in such an exempt pool by non-U.S. persons, regardless of their financial sophistication (*i.e.*, without regard to any accredited investor status or similar requirement). The CFTC acknowledges that market participants relying on such exemption are generally already not considering whether non-U.S. participants meet any investor sophistication criteria, in reliance on CFTC Staff Letter 04-13.

Expanding Prohibition on Statutory Disqualifications

In contrast to Advisory 18-96, which requires that neither the registered CPO nor its principals be subject to any statutory disqualification under section 8a(2) or 8a(3) of the CEA (subject to certain exceptions), no such condition currently applies to any of the CPO registration exemptions under CFTC regulation 4.13.

To address the risk posed to customers of exempt CPOs and the incongruity with the conditions for operating registered CPOs, the Proposed Rules would amend CFTC regulation 4.13 to impose such a prohibition and to require any person claiming the CPO *de minimis* exemption under clause (a)(3) or an exemption under existing clauses (a)(1), (2), or (5), or the proposed 18-96 Exemption,⁵ to represent that neither the CPO nor any of its principals is subject to any such statutory disqualification. This prohibition and the corresponding representation are subject to certain exceptions based on those in Advisory 18-96, which would permit statutory disqualifications that were previously disclosed in registration applications that were granted, or that were disclosed more than 30 days prior to claiming the exemption.

As proposed, current claimants under CFTC regulation 4.13 would be required to make this representation (and come into compliance with the prohibition) at the time of their next annual affirmation filings (renewing their claims). CPOs filing new claims for any such exemption would be required to make the representation (and be in compliance) upon filing such exemption.

⁵ This prohibition would not apply to qualifying Family Offices relying on the exemption described below (under proposed CFTC regulation 4.13(a)(8)).

Family Office Exemption

Background

In 2011, the Securities and Exchange Commission (the “SEC”) adopted an exclusion for Family Offices from the term “investment adviser,” as defined in the Investment Advisers Act of 1940 (the “Advisers Act”), excluding Family Offices from regulation under the Advisers Act.⁶ Family Offices relying on such exclusion are restricted to managing assets of and providing services solely to “Family Clients” (as defined in the SEC regulations).

In 2012, following rescission of the former exemption under CFTC regulation 4.13(a)(4) (on which many Family Offices had previously relied), the CFTC issued a no-action letter (the “CPO Family Office Letter”)⁷ granting no-action relief from CPO registration to any Family Office that operates or manages the assets of the Family Office and/or Family Clients.

Subsequently, the CFTC issued another no-action letter (the “CTA Family Office Letter”)⁸ granting no-action relief with respect to CTA registration for any Family Office that provides commodity trading advice solely to the Family Office itself and/or Family Clients, provided the Family Office does not hold itself out to the public as a CTA.

Proposed Rules

The Proposed Rules would amend CFTC regulations 4.13 and 4.14 to codify the CPO Family Office Letter and CTA Family Office Letter, providing relief from CPO and CTA registration to qualifying Family Offices with respect to investment management and advisory activities conducted on behalf of Family Clients, based on terms similar to those in such no-action letters.

⁶ The SEC regulations define “Family Office” as a company (including its directors, partners, members, managers, trustees and employees acting within the scope of their position or employment) that has no clients other than family clients, is wholly owned by family clients, is exclusively controlled (directly or indirectly) by one or more family members and/or family entities, and does not hold itself out to the public as an investment adviser.

⁷ For additional information on the CPO Family Office Letter, see our client memorandum, available at: <https://www.debevoise.com/insights/publications/2012/12/cftc-grants-noaction-relief-to-family-offices-an->.

⁸ For additional information on the CTA Family Office Letter, see our client memorandum, available at: <https://www.debevoise.com/insights/publications/2014/12/cftc-grants-family-offices-no-action-relief>.

Specifically, the Proposed Rules would add a new CFTC regulation 4.13(a)(8), providing that a person need not register as a CPO if:⁹

- Interests in the pool are exempt from registration under the Securities Act of 1933 (the “Securities Act”) and are offered and sold solely to Family Clients (as defined above);
- The pool qualifies as a Family Office (as defined above); and
- The person reasonably believes, at the time of investment, or in the case of an existing pool, at the time of conversion to a pool meeting the criteria of this exemption, that each participant in the pool is a Family Client of a Family Office.

The CPO exemption would not be self-executing; rather, persons relying on this exemption would be required to file a notice of exemption with the NFA, similar to the notice required for CPOs claiming the *de minimis* exemption, as well as annual affirmation filings.

In addition, a registered CPO that intends to withdraw from registration with respect to a qualifying pool in order to claim this exemption would be required to provide written notice to such pool’s participants that it intends to withdraw from registration and claim the exemption, and to provide each such participant with a right to redeem its interest in such pool prior to filing the notice of exemption with the NFA.

With respect to CTAs, the Proposed Rules would add a new CFTC regulation 4.14(a)(11), providing that a person need not register as a CTA if its commodity trading advice is solely directed to (and for the sole use of) Family Clients (as defined in the SEC regulations). This exemption, like most exemptions under CFTC regulation 4.14, would be self-executing.

General Solicitation Under the Jobs Act

Background

Rule 506(b) of the SEC’s Regulation D provides a safe harbor from the registration requirements of the Securities Act for certain private offerings to accredited investors (as defined in Regulation D). In general, an issuer is prohibited from using any form of

⁹ Family Offices that are unable to meet the requirements of the exemptions in the Proposed Rules may still rely on the CPO *de minimis* exemption (if they qualify) or may seek relief on an individual, firm-by-firm basis through requests to CFTC staff.

general solicitation in offering or selling securities under Rule 506(b) (the “General Marketing Restriction”).

Following the enactment of the JOBS Act of 2012, the SEC adopted new Rule 506(c) under Regulation D, permitting an issuer that engages in general solicitation or advertising to offer and sell securities under Regulation D, provided the issuer meets certain conditions in Regulation D, including that all purchasers are accredited investors and that the issuer takes reasonable steps to verify each purchaser’s status as such.¹⁰ In other words, the General Marketing Restriction is not applicable to securities offerings made pursuant to Rule 506(c).

The SEC also amended Rule 144A(d)(1), which permits resales of securities pursuant to Rule 144A using general solicitation, so long as securities are sold to a qualified institutional buyer (“QIB”) or to a purchaser that the seller and any person acting on the seller’s behalf reasonably believe is a QIB (such sellers, “144A Resellers”).

In 2014, CFTC staff granted exemptive relief permitting general solicitation under certain circumstances by a CPO that relies on the CPO *de minimis* exemption or CFTC regulation 4.7(b). The letter granting such relief (the “JOBS Act Letter”) was intended to facilitate the use of SEC Rules 506(c) and 144A(d)(1) by a range of CPOs, including private fund and securitization sponsors.¹¹ Prior to the JOBS Act Letter, certain CPOs that might otherwise have relied on Rule 506(c) or employed 144A Resellers were caught in a conflict with the more permissive SEC amendments. The JOBS Act Letter removed these roadblocks to the use of Rule 506(c) by granting exemptive relief from the requirement in CFTC regulation 4.13(a)(3)(i) that securities be “offered and sold without marketing to the public,” and from the requirements in CFTC regulation 4.7(b) that an offering be exempt pursuant to section 4(a)(2) of the Securities Act and offered solely to “qualified eligible participants” (“QEPs”), subject to certain conditions. Thus, by making CFTC regulations 4.7(b) and 4.13(a)(3) compatible with amended SEC Rules 506(c) and 144A, the JOBS Act Letter permitted a CPO that filed a required notice with CFTC staff to engage in general solicitation as contemplated by those SEC regulations.

Proposed Rules

The Proposed Rules would amend CFTC regulations 4.7(b) and 4.13(a)(3) to generally be consistent with the JOBS Act Letter.

Specifically, CFTC regulation 4.13(a)(3)(i) would be amended to require that interests in the commodity pool must be exempt from registration under the Securities Act and

¹⁰ To rely on Rule 506(c), the terms of sections 230.501 and 230.502(a) and (d) must also be satisfied.

¹¹ For additional information on the JOBS Act Letter, see our client memorandum, available at: <https://www.debevoise.com/insights/publications/2014/09/cftc-opens-door-for-use-of-jobs>.

marketed and advertised to the public in the United States *solely, if at all, in compliance with Regulation D or Rule 144A.*

In addition, CFTC regulation 4.7(b) would be amended by removing references to “section 4(2) of [the Securities Act]” and to the act of “offering” the relevant pool, and by deleting the phrase “without marketing to the public.” As proposed, the amended CFTC regulation 4.7(b) would provide that the relief available under such section from various disclosure, reporting and recordkeeping requirements will be available to a registered CPO that offers or sells interests in a pool pursuant to Regulation D or resells such interests pursuant to Rule 144A (in addition to the types of offerings currently contemplated by CFTC regulation 4.7(b), including offerings under section 4(a)(2) of the Securities Act and offerings pursuant to Regulation S under the Securities Act), provided the interests in the pool are *sold* solely to QEPs. A registered CPO relying on CFTC regulation 4.7(b) would still need to file the required notice and otherwise comply with the requirements of CFTC regulation 4.7(d) in operating the exempt pool.

Relief for Business Development Companies

Background

Business development companies (“BDCs”) are closed-end investment companies that have elected to be regulated under the Investment Company Act of 1940, and which are exempt from registration under such Act. Accordingly, the exclusion from the definition of CPO available to registered investment companies pursuant to CFTC regulation 4.5 does not apply to BDC operators. Absent an exemption or relief from CFTC staff, a BDC operator that trades commodity interests would likely be required to register as a CPO.

In 2012, CFTC staff issued a no-action letter (the “BDC Letter”) granting relief from CPO registration to BDC operators that submit a claim for relief and satisfy a *de minimis* threshold and certain conditions set forth in the letter.¹²

Proposed Rules

The Proposed Rules would amend CFTC regulation 4.5 to exclude registered investment advisers of BDCs from the CPO definition on the same terms as investment advisers of registered investment companies, and to make certain conforming amendments.

¹² In granting the relief, CFTC staff noted that BDCs are subject to oversight by the SEC that is comparable to the regulation of registered investment companies, and that BDCs use commodity interests primarily for bona fide hedging purposes. For additional information on the BDC Letter, see our client memorandum, *available at: <https://www.debevoise.com/insights/publications/2012/12/cftc-issues-interpretive-guidance-and-registrati>*.

Consistent with the existing requirement for investment advisers of registered investment companies, investment advisers of BDCs relying on this proposed exclusion would be required to file a notice of eligibility with the NFA and to affirm this claim on an annual basis.

Relief from Requirements to File Forms CPO-PQR and CTA-PR

Background

Pursuant to CFTC regulation 4.27, a CPO that is registered or required to register must file Form CPO-PQR with the NFA to provide certain information regarding its operations and each commodity pool it operates. Similarly, CFTC regulation 4.27 requires a CTA that is registered or required to register to file a Form CTA-PR with the NFA to provide information regarding its operations and the pool assets that it directs.

Based on a plain reading of the current language of CFTC regulation 4.27, and absent an exemption or relief from CFTC staff, these requirements to file a Form CPO-PQR and/or CTA-PR would apply to a CPO and/or CTA (as applicable) that is registered (or required to be registered) irrespective of whether the CPO and/or CTA (as applicable) claims an exemption with respect to the relevant pools (and even where the CPO and/or CTA has registered despite not operating or directing any trading of any commodity pools, respectively).

In a 2014 letter (the “CPO-PQR Letter”)¹³ responding to a request from the NFA, CFTC staff granted no-action relief from the obligation to file a Form CPO-PQR to those CPOs that are registered with the CFTC but only operate pools pursuant to an exemption from registration or an exclusion from the definition of CPO (such that they otherwise have no reporting obligations under Part 4 of the CFTC regulations). In granting this relief, CFTC staff noted that requiring such a CPO that only operates pools pursuant to CFTC regulations 4.5 or 4.13(a)(3) to report on Form CPO-PQR would provide limited additional information regarding such CPO beyond that already available to the CFTC as part of the registration process and the CPO’s ongoing obligations as a registrant.

In a 2015 letter (the “CTA-PR Letter”),¹⁴ based on the same rationale as the CPO-PQR Letter, CFTC staff granted no-action relief from the obligation to file a Form CTA-PR to

¹³ For additional information on the CPO-PQR Letter, see our client memorandum, available at:

<https://www.debevoise.com/insights/publications/2014/09/cftc-issues-relief>.

¹⁴ See CFTC Staff Letter 15-47 (July 21, 2015), available at:

<https://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/15-47.pdf>.

those CTAs that are registered with the CFTC but do not direct any trading of commodity interest accounts.

Proposed Rules

The Proposed Rules would amend CFTC regulation 4.27 in a manner consistent with the exemptive relief currently available under the CPO-PQR Letter and the CTA-PR Letter, such that a CPO that operates only pools for which it is otherwise excluded from the CPO definition or exempt from CPO registration is not required to file a Form CPO-PQR, and a CTA that does not direct client commodity interest accounts is not required to file a Form CTA-PR.

In addition, the Proposed Rules would expand the exemption from the requirement to file a Form CTA-PR to cover registered CPOs that comply with the terms of the exemption from CTA registration under CFTC regulation 4.14(a)(4) (*i.e.*, directing commodity trading advice solely to pools for which it is registered as a CPO),¹⁵ but nonetheless elect to register as CTAs. As registered CPOs are already required to file a Form CPO-PQR (which requires more information than Form CTA-PR), the CFTC notes that the value of any data that would be collected by requiring that same person to file a Form CTA-PR is significantly outweighed by the burden of an extra filing and the inefficiency of collecting duplicative data.

Similarly, the Proposed Rules would expand the exemption from the requirement to file a Form CTA-PR to cover exempt CPOs that comply with the terms of the exemption from CTA registration under CFTC regulation 4.14(a)(5) (*i.e.*, directing commodity trading advice solely to pools that it operates as an exempt CPO).¹⁶ As the exempt CPO would not be required to report on Form CPO-PQR (under the CPO-PQR Letter and the Proposed Rules), it would be incongruent to require the same person to report on Form CTA-PR with respect to the operation of a pool for which it is not required to file a Form CPO-PQR.

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Please do not hesitate to contact us with any questions.

¹⁵ CFTC regulation 4.14(a)(4) provides that a person is exempt from registering as a CTA if such person is registered as a CPO and directs its commodity trading advice solely to pools for which it is registered as a CPO.

¹⁶ CFTC regulation 4.14(a)(5) provides that a person is exempt from registering as a CTA if such person is exempt from CPO registration and directs its commodity trading advice solely to pools for which it is so exempt.

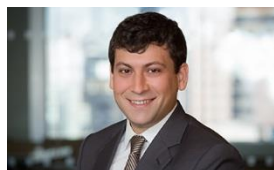
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