

# CFTC's Proposal to Repeal or Restrict Exemptions from Commodity Pool Operator and Commodity Trading Advisor Regulation

The Commodity Futures Trading Commission (the "CFTC") has proposed rules that would remove the exemptions that many US fund managers and non-US fund managers of US funds currently rely on to avoid the need to register as commodity pool operators ("CPOs") and commodity trading advisors ("CTAs") in the United States.

Under the current CFTC Rules 4.5, 4.13(a)(3) and 4.13(a)(4), many fund managers advising investment companies registered under the Investment Company Act of 1940, as amended ("RICs") and privately offered funds that trade futures and related options ("**regulated commodity interests**") have been able to rely on exemptions from the need to register as CPOs or CTAs. The CFTC proposals would rescind the exemptions from CPO registration under Rules 4.13(a)(3) and 4.13(a)(4) for operators of privately offered funds and add conditions for RICs claiming relief from CPO regulation under Rule 4.5. As a result, if the CFTC proposals are adopted, operators of private funds that invest even in a minimal amount of assets in regulated commodity interests, beginning July 16, 2011, swaps, would be required to register with the CFTC as CPOs and become members of the National Futures Association (the "NFA"). In addition if the proposal is adopted, investment advisers that currently operate under an exemption from CTA registration based on the fact that they provide advice only to pool operators that are exempt under Rules 4.13(a)(3) and 4.13(a)(4) will be required to register as CTAs with the CFTC and also become NFA members. These advisers will also be subject to the full scope of CFTC and NFA requirements applicable to CTAs.

## Repeal of CPO Exemptions for Privately Offered Funds

CFTC Rule 4.13(a)(3) currently exempts from the CPO registration requirement any person that operates a pool which (i) is exempt from registration under the Securities Act of 1933, as amended ("**33 Act**"); (ii) is offered only to sophisticated investors referred to as qualified eligible persons ("**QEPs**"), accredited investors, or knowledgeable employees; and (iii) has the aggregate initial margin and/or premium attributable to commodity interests that does not exceed 5% of the liquidation value of its portfolio. The CFTC is proposing to eliminate this exemption, on the grounds it is possible for a pool to have a sizeable portfolio even if it meets five percent condition in the rule.

CFTC Rule 4.13(a)(4) currently exempts from the CPO registration operator of a commodity pool which is (i) exempt from registration under the '33 Act and (ii) offered only to institutional QEPs and natural persons who meet both definitional and portfolio QEP requirements, irrespective of the amount of commodity interests held by the pool. The CFTC proposes to eliminate this exemption because of an expressed concern that there are no limits on the amount of regulated commodity interests, making it possible for a Rule 4.13(a)(4) pool to be invested solely in regulated commodity interests. The CFTC has also proposed to rescind the current exemption from CTA

### Key Issues

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**Repeal of CPO Exemptions for Privately Offered Funds**

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**Restrictions on Use of Commodity Interests and Marketing for RICs Relying on the CFTC Rule 4.5 CPO Exclusion**

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**CPO and CTA Registration Process**

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**Effective Date**  
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registration for advisors to these kinds of private funds currently set out under Rule 4.14(a)(8)(i)(D).

If the CFTC proposal is adopted, the exemption from CPO registration would continue to be available only to private fund operators that (i) operate only one commodity pool, do not solicit participants for that pool, do not receive compensation for operating the pool, and are not affiliated with any person required to register with the CFTC; or (ii) operate pools each of which has 15 or fewer participants and a combined total gross capital contribution not exceeding \$400,000.

## Restrictions on Use of Commodity Interests and Marketing for RICs Relying on the CFTC Rule 4.5 CPO Exclusion

CFTC Rule 4.5 currently excludes certain pension plans, insurance company separate accounts, bank collective trusts and accounts and RICs from the definition of a CPO. The CFTC proposal would condition this exclusion on representing that the regulated commodity interests acquired for non-*bona fide* hedging do not represent more than five percent of the liquidation value of the qualifying entity's portfolio and that the entity will not market the fund as a commodity pool to the public. As a result, an operator of a registered investment company will no longer be able to rely on the CFTC Rule 4.5 for exclusion from the CPO registration if the investment company invests more than an immaterial amount of its assets for speculative purposes in regulated commodity interests. From July 16, 2011, regulated commodity interests will include swaps.

## CPO and CTA Registration Process

Registration as a CPO or a CTA, in ordinary circumstances prior to the enactment of the Dodd-Frank Act, typically took approximately six to eight weeks to complete. Since the Dodd-Frank Act includes additional registration categories which are likely to require significant numbers of entities to apply for registration at roughly the same time, and consequently to place unprecedented demands on the NFA, the registration process may correspondingly take longer once the rules have been adopted.

Applicants for registration must submit a Form 7-R for the CPO and the CTA and a Form 8-R for each principal who is a natural person and for each associated person ("**AP**") of the CPO or CTA. The Form 8-R must be submitted with the relevant person's fingerprints and background checks. In addition, each AP of the CPO and the CTA would be required to pass a required proficiency exam. Each registered CPO and CTA would be required to have at least one AP. Unlike operators currently operating under the exemption, fully registered CPOs will also be subject to the CFTC and the NFA regulation. Such regulation includes disclosure document delivery, recordkeeping and periodic and annual reporting requirements, including delivery of audited annual financial statements to each pool participant.

## Effective Date

The comment period for the CFTC's proposed rulemaking will end on June 3, 2011. The CFTC must then consider the comments and publish amended rules, or, if no changes are to be made, the final rule. The final rule is likely to specify an effective date by which all relevant entities must be registered as CPOs or CTAs, as applicable. As noted above, the registration process is likely to require a significant effort on the part of the NFA, as well as on the applicants, and the CFTC is likely to take this into account when setting the effective date for the rulemaking. It is not currently possible to predict when that effective date is likely to be.

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