

Stradley Ronon Stevens & Young, LLP
2005 Market Street
Suite 2600
Philadelphia, PA 19103-7018
215.564.8000 Telephone
215.564.8120 Facsimile
www.stradley.com

With other offices in:
Washington, D.C.
New York
New Jersey
Illinois
Delaware

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More than Meets the Eye: The CFTC's First Round of KISS Proposals for CPOs and CTAs

I. Introduction and Executive Summary

On October 9, 2018, the Commodity Futures Trading Commission (the “CFTC” or the “**Commission**”) issued the first set of proposed amendments to its commodity pool operator (“CPO”) and commodity trading advisor (“CTA”) registration and compliance regulations generated by Project KISS, the Commission’s agency-wide regulatory simplification initiative launched in the spring of 2017 (the “**Proposal**”).¹ A key goal of the Proposal is to streamline and simplify regulations for CPOs and CTAs in order to make them less burdensome and costly while maintaining their regulatory benefits. The CFTC has requested comments from market participants on a range of general and specific questions relating to whether the Proposal and its individual components meet the CFTC’s intended objectives.

The release accompanying the Proposal (the “**Proposing Release**”) clearly demonstrates the commitment of the CFTC, and in particular the Division of Swap Dealer and Intermediary Oversight (“**DSIO**”), to improving the CFTC’s regulation of CPOs and CTAs, both by reducing unnecessary regulatory burdens and increasing regulatory certainty. On the other hand, certain components of the Proposal could, in practice, have the effect of adding rather than reducing regulatory burdens, as well as creating rather than reducing regulatory uncertainty.

Accordingly, the Proposal merits close attention and careful review by asset managers engaging in CPO and CTA activities, especially those that rely on existing exemptions for offshore and private funds, both to ensure support for those aspects of the Proposal that further the CFTC’s goals and to identify and weigh in on those that could have a contrary impact on their activities. This Regulatory Alert outlines the main components of the Proposal, focusing on those areas on which the CFTC has expressly requested comment and indicated that it would welcome input from industry participants.

Comments on the Proposal are due no later than December 17, 2018.

II. New Exemption for CPOs of Offshore Pools

A. Summary of Proposal

The CFTC is proposing to add a new exemption for CPOs of offshore pools that meet the following criteria:

- The pool is, and will remain, organized and operated outside of the U.S.;

- The pool will not hold meetings or conduct administrative activities within the U.S.;
- No shareholder of or other participant in the pool is or will be a U.S. person;
- The pool will not receive, hold or invest any capital directly or indirectly contributed from sources within the U.S.; and
- The person claiming the exemption, the pool, and any person affiliated therewith will not undertake any marketing activity for the purpose, or that could reasonably be expected to have the effect, of soliciting participation in the pool from U.S. persons.²

The proposed exemption, which would be added as a new Rule 4.13(a)(4), would be available to registered as well as exempt CPOs, on a pool-by-pool basis; would require the CPO claiming the exemption to make a filing with the National Futures Association (“NFA”) representing compliance with the rule’s eligibility requirements (which must be reaffirmed annually); and would incorporate as a requirement the statutory disqualification prohibition described below.

B. Policy Rationale

The Proposing Release identifies two related policy goals underlying the proposed offshore pool exemption: (1) focusing the CFTC’s limited resources on domestic rather than offshore activities, and (2) expanding and making more flexible the exemptions available for operators of offshore pools.

With respect to the first goal, the Proposing Release cites the CFTC’s previous statement regarding its jurisdictional scope and historical prioritization of agency resources for the regulation of intermediary activities affecting U.S. participants:

[G]iven this agency’s limited resources, it is appropriate at this time to focus [the Commission’s] customer protection activities upon domestic firms and upon firms soliciting or accepting orders from domestic users of the futures markets and that the protection of foreign customers of firms confining their activities to areas outside this country, its territories, and possessions may best be for local authorities in such [jurisdictions].³

With respect to the second goal, the Proposing Release states that the proposed exemption is intended to provide more comprehensive relief for offshore CPO activities than is currently available under either Staff Advisory 18-96 or CFTC Rule 3.10(c)(3)(i).⁴ In particular, by making the proposed offshore pool exemption available on a pool-by-pool basis,

the CFTC intends to offer additional flexibility to CPOs that operate and offer to participants a mix of onshore and offshore pools. The Proposing Release explains the additional flexibility intended by the new exemption as follows:

Under [Rule] 3.10(c)(3)(i), an offshore CPO that wished to operate pools offered to U.S. persons would be required to choose between the potentially more costly options of having such pools operated by an affiliate registered with the Commission or otherwise eligible for other relief, operating all pools (regardless of location) consistent with another registration exemption, or registering as a CPO and listing all operated pools with the Commission. In contrast, the proposed 18-96 Exemption would enable the CPO to register, or claim an alternative registration exemption such as [Rule] 4.13(a)(3), with respect to its commodity pools offered to U.S. persons, but remain exempt from CPO registration, pursuant to proposed [Rule] 4.13(a)(4), with respect to its qualifying offshore pools.

C. The Commission’s Requests for Comment

The Commission has requested comment on the proposed new offshore pool exemption, both generally (including whether the Commission has appropriately considered the costs and benefits of the exemption), and with respect to certain specific matters, including, among other things, (1) the interaction of the proposed exemption with Rule 3.10(c)(3)(i) and whether that interaction is understood, and (2) whether the pool-by-pool provisions of the exemption, as proposed, are clear and effective for both registered and exempt CPOs.

Of particular note for asset managers with significant cross-border activities, especially activities conducted by offshore affiliates, are the statements in the Proposing Release about the application of Rule 3.10(c)(3)(i) to exempt (unregistered) offshore CPOs. While it is not entirely clear, some of these statements could be read to limit the availability of Rule 3.10(c)(3)(i) for exempt offshore CPOs in a manner that is not widely understood and that could impose substantial regulatory burdens on offshore activities that do not involve U.S. investors. Comment on this aspect of the Proposal and its potential impact would be directly responsive both to the CFTC’s specific questions and its general request for comment on consideration of the costs and benefits of the Proposal.

In addition, with respect to commenting on the goals of regulatory certainty and additional flexibility, it may be relevant that proposed Rule 4.13(a)(4) would, by its terms, prohibit investment by any U.S. person, but does not include a definition of the term “U.S. person.” As also indicated by the eligibility criteria cited above, the exemption as

proposed does not provide for a “reasonable belief” standard, a de minimis threshold for U.S. investment (including seed money), or any flexibility for inadvertent U.S. investors, such as when a non-U.S. investor later moves to the U.S.

III. Addition of a New Statutory Disqualification Prohibition on Claiming Existing CPO Exemptions

A. Summary of Proposal

The Proposal would add a new statutory disqualification condition for CPOs claiming a number of existing exemptions available under Rule 4.13(a), including Rule 4.13(a)(3), the CPO exemption available to operators of private funds with de minimis commodity trading activities.⁵ The new condition, which would be set forth in a new paragraph (6) to Rule 4.13(a), would also apply to the proposed new offshore pool exemption, described above.

The Proposing Release describes the new condition as a “prohibition” or “bar” on statutory disqualifications. Under proposed Rule 4.13(a)(6), any person seeking to claim a CPO exemption under any of the exemptions available under Rule 4.13(a)(1)-(a)(5) must represent, and recertify annually, that neither that person nor any of its principals is “subject to any statutory disqualification under section 8a(2) or 8a(3) of the [Commodity Exchange Act (“CEA”)], unless such disqualification arises from a matter which was previously disclosed in connection with a previous application, if such registration was granted, or which was disclosed more than thirty days prior to the claim of this exemption.”

CPOs that currently claim an exemption under Rule 4.13(a)(3) or the other applicable exemptions would be permitted to continue to rely on that exemption only if they comply with the new statutory disqualification prohibition. Compliance with the new requirement would be required as these currently exempt CPOs reaffirm their claims on an annual basis.

B. Policy Rationale

The rationale for imposing the new statutory disqualification condition on exempt CPOs is primarily based on customer protection concerns. The Proposing Release states that the proposed amendment would provide additional customer protection because “statutorily disqualified, unregistrable persons would no longer be permitted to claim the CPO exemptions under [Rules 4.13(a)(1)-(a)(5)].” The Proposing Release explains the statutory disqualification provisions as follows:

Under CEA section 8a(2), for instance, the Commission may refuse to register a person who has been temporarily or permanently enjoined by order not to act as a Commission registrant, or

to refrain from engaging in financially criminal activities, or who, within ten years preceding the application for registration with the Commission, has been convicted of a felony for criminal activities involving commodity interests or securities, or been found by the Commission or another governmental body or agency to have violated the CEA, Commission regulations, or securities laws.

Accordingly, the proposed new prohibition on statutory disqualifications would “provid[e] additional protection to members of the public by reducing the possibility of fraud and other illegal conduct in exempt pools offered by such persons.”⁶

C. The Commission’s Requests for Comments

The CFTC has specifically requested comment on the impact of adopting this provision on industry participants and currently exempt CPOs, and whether it has accurately identified the costs and benefits of this aspect of the Proposal. In particular, commenters are asked to address whether the limited exceptions proposed for statutory disqualifications that have been disclosed would successfully address any unintended consequences of adding the prohibition to Rule 4.13, while still providing a base level of customer protection. The Commission also asks how the implementation of the statutory disqualification prohibition should be handled, and how the prohibition should apply to current claimants under the applicable Rule 4.13(a) exemptions.

These requests indicate that the CFTC is particularly interested in assessing the potential impact on CPOs currently relying, or intending to rely, on Rule 4.13(a)(3) and the other relevant exemptions, relative to the potential customer protection benefits. In assessing the potential burdens and implementation questions posed by the CFTC, commenters may find it helpful to review the categories of conduct identified in sections 8a(2) and 8a(3) of the CEA, and consider (1) whether any of the categories would apply, either to the entity itself or any of its principals, and thus serve to make the firm ineligible to claim the exemption and (2) what type of monitoring would be required to confirm the absence of a statutory disqualification, either for the firm or any of its principals, and thus continued eligibility for the exemption, on an ongoing basis. These considerations may be affected in particular by the range of conduct referred to in section 8a(3), which goes beyond fraud and financial crime, and is broader than the range of conduct than would be considered a statutory disqualification under analogous Securities and Exchange Commission (“SEC”) provisions.⁷

In addition, the potential impact of the new condition will depend on how the disclosure exception is implemented for exempt CPOs. The proposal contemplates that circumstances that are disclosed 30 days before the claim of exemption is made will not trigger the statutory disqualification bar.

IV. Forms CPO-PQR and CTA-PR Filing Relief for Certain Registered CPOs and CTAs

A. Summary of Proposal

The CFTC is proposing amendments to Rule 4.27, the CFTC's reporting rule that requires registered CPOs and CTAs to file with the NFA reports on Forms CPO-PQR and CTA-PR, respectively, that would eliminate the relevant filing requirement for the following categories of registered CPOs and CTAs:

- (1) Registered CPOs that operate only pools for which they rely on the CPO exclusion provided by Rule 4.5 and/or the exemption from CPO registration under Rule 4.13 (collectively “**exempt pools**”); and
- (2) Registered CTAs that either (a) do not direct the trading of any commodity interest accounts or (b) direct only the accounts of commodity pools for which the CTA also serves as a registered or exempt CPO and relies on the CTA exemptions available for such CPOs.⁸

These proposed amendments to Rule 4.27 would codify and expand filing relief provided in two previous staff exemptive letters, by excluding these CPOs and CTAs from the definition of “reporting person” under the rule.⁹

B. Policy Rationale

The exemptive letters proposed to be codified recognized that, for certain types of CPOs and CTAs, the filing of Form CPO-PQR or Form CTA-PR would provide limited additional information regarding the CPO or CTA beyond the information already available to the Commission (as part of the registration process and the CPO's or CTA's ongoing reporting and other obligations as registrants). Therefore, requiring these registrants to file Form CPO-PQR or Form CTA-PR would not further the purposes of the CFTC's regulations.

C. The Commission's Request for Comment

The CFTC has asked for comment on whether there are any additional classes of registered CPOs or CTAs that should be excluded from the definition of a “reporting person” under Rule 4.27, thus eliminating for them the requirement to file Form CPO-PQR or Form CTA-PR. If so, the CFTC asks that commenters identify the class or classes, and explain why they should be so excluded.

V. Codification of CPO and CTA Exemptive Relief for Family Offices

A. Summary of Proposal

The CFTC is proposing registration relief for CPOs and

CTAs of entities qualifying as “family offices” under rules adopted by the SEC under the Investment Advisers Act of 1940 (“**Advisers Act**”), which exclude advisers to family offices from the definition of investment adviser under the Advisers Act (“**SEC Family Office Exclusion**”).¹⁰ The CFTC's proposed exemptions would codify registration relief previously provided in two staff no-action letters.¹¹

The proposed CPO registration relief would be provided in new Rule 4.13(a)(8), under which a CPO would not be required to register as such, if, for each pool for which the person claims exemption from registration under the new rule, (i) interests in the pool are exempt from registration under the Securities Act of 1933, and such interests are offered and sold only to “family clients” as defined in the SEC Family Office Exclusion; (ii) the pool qualifies as a “family office,” as defined in the SEC Family Office Exclusion; and (iii) 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 Rule 4.14(a)(8), that each person who participates in the pool is a “family client” of a “family office,” as defined in the SEC Family Office Exclusion.

Any person claiming CPO registration relief under proposed Rule 4.13(a)(8) would be required to file a notice claiming such relief, as well as an annual notice confirming that the person remains exempt from registration. The proposed family office exemption would not impose the statutory disqualification prohibition discussed above, which is proposed to be added to the eligibility criteria for the other exemptions available under Rule 4.13(a).

With respect to CTAs, the CFTC has proposed a new Rule 4.14(a)(11), which would provide registration relief for advice provided to individual family clients.¹² Reliance on the proposed CTA registration relief would be self-executing and would not require filing a notice.

B. Policy Rationale

The policy basis described in the Proposing Release has two main components: (1) reduction of burdens commensurate with the CFTC's regulatory interest, and (2) harmonization with SEC requirements and the resulting elimination of unnecessary dual regulation.

With respect to the level of its regulatory interest, the Commission preliminarily believes that the familial relationships inherent in family offices provide a reasonable mechanism for protecting the interests of family clients and resolving disputes amongst them, and that these characteristics are a reasonable substitute for the benefits and protections afforded by the Commission's regulatory regime for CPOs and CTAs. Accordingly, the regulatory interest is lower than in typical, arms-length transactions between CPOs and CTAs and their

pool participants and advisory clients. Moreover, the prohibition against solicitation of non-family clients ensures that the exempt CPO is limiting its activities to those associated with the operation of a family office, as contemplated by the SEC Family Office Exclusion, which the Commission preliminarily believes would also reduce its regulatory interest in such investment vehicles, when compared to other commodity pools.

With respect to alignment of CFTC and SEC regulation, the Proposing Release notes that as a result of harmonizing the CFTC's treatment of family offices with that of the SEC, family offices would generally only be required to comply with one standard to determine their registration and compliance obligations with respect to both their securities and commodity interest transactions. In the family office no-action letters that the proposed amendments would generally codify, DSIO observed that the fundamental issue of the appropriate application of investor protection standards as required by each respective agency's regulations is substantially similar in the case of family offices, and that placing both agencies on equal footing with respect to the application of investor protections relevant to this issue would facilitate compliance with both regulatory regimes.

C. The Commission's Requests for Comment

The CFTC has requested comment on the proposed family office exemptions, including whether CPOs claiming the exemption, as proposed, should be required to file a claim for the exemption and annually recertify their eligibility, what costs and burdens the annual filing requirement would impose, and whether the notices filed by family offices should be included in the NFA's public BASIC database.

These requests for comment also raise more generally the alignment of the proposed family office exemptions with the SEC's approach to the same activities. The CFTC's proposed approach differs from the SEC's in two respects. First, under the SEC rules, family offices are excluded from the definition of an investment adviser, while the CFTC proposal is an exemption from registration. The SEC's approach is more similar to an earlier approach taken by the CFTC toward family offices, which is that such arrangements are not commodity pools.¹³ Second, the SEC does not require a filing for family offices eligible for the exclusion.

VI. Additional Components of the Proposal

A. Amendment of Rule 4.5 to Identify the Investment Adviser to an SEC-Registered Fund as the CPO

The CFTC is proposing to amend Rule 4.5(a)(1), which provides an exclusion from the definition of CPO for operators of investment companies registered with the SEC under the Investment Company Act of 1940 (the "ICA")

(**"Registered Funds"**) that meet the commodity interest trading and marketing criteria in the rule, to designate the Registered Fund's investment adviser as the person excluded from the CPO definition. In its current form, Rule 4.5 provides a CPO exclusion for the Registered Fund itself, rather than the Fund's adviser. The Proposal would align with the CFTC's determination in 2012 that for Registered Funds that do not meet the trading and marketing tests and thus are outside of the scope of the Rule 4.5 exclusion, the Registered Fund's investment adviser is the appropriate person to serve as the Fund's CPO for regulatory purposes.¹⁴

B. CPO Exclusion for Investment Advisers to Business Development Companies ("BDCs")

The CFTC is proposing amendments to Rule 4.5 to provide a CPO exclusion for investment advisers of "business development companies" (as that term is defined in the ICA) that meet the same commodity interest trading and marketing restrictions imposed by the rule on Registered Funds. The proposed amendments would be consistent with no-action relief previously provided to investment advisers of BDCs.¹⁵

BDCs are primarily engaged in investing in, and providing managerial assistance to, operating companies. In this capacity, BDCs typically use commodity interests for purposes of hedging, reducing, or otherwise managing investment and commercial risks of the operating companies in which they invest. While BDCs are not registered as investment companies under the ICA, they operate in a manner similar to closed-end Registered Funds and are subject to many of the same operational requirements of the ICA. For these reasons, the CFTC preliminarily believes that advisers of BDCs should be subject to the same operational requirements as CPOs of Registered Funds, and has proposed the amendment of Rule 4.5 to provide advisers of BDCs with comparable exclusionary relief.

C. Harmonization with SEC JOBS Act Rules

The CFTC is proposing tailored amendments to Rules 4.7(b) and 4.13(a)(3) that would permit qualifying CPOs of private funds to engage in general solicitation in their pool offerings under the limited circumstances contemplated by the Jumpstart Our Business Startups Act of 2012 ("**JOBS Act**") and as permitted by related SEC rules adopted in 2013.¹⁶ The proposed amendments would, among other things, adjust the prohibitions on marketing to the public currently set forth in both Rules 4.7(b) and 4.13(a)(3) to harmonize these prohibitions with SEC Rules 506(c) and 144A, which in accordance with the JOBS Act, permit issuers relying on certain private offering exemptions from the SEC's registration requirements to engage in general solicitation, as long as the issuer takes reasonable steps to ensure that all purchasers in the offerings meet the investor qualification standards for the relevant exemption (accredited

investor status for Rule 506(c) and qualified institutional buyer status for Rule 144A). The proposed amendments would generally codify an exemptive letter previously provided by DSIO to achieve this harmonization of CFTC and SEC rules.¹⁷

The Proposing Release states that these amendments are generally designed to harmonize the impact of the JOBS Act on, and to provide legal certainty with respect to the transactions engaged in by, dually regulated CFTC and SEC entities. In particular, the Release notes the CFTC's preliminary belief that the proposed harmonization of CFTC Rules 4.7(b) and 4.13(a)(3) with the SEC's JOBS Act amendments to Regulation D and Rule 144A would provide a substantial benefit by aligning CFTC regulations with those of its sister regulator, in the interest of fostering cooperation and comity, especially where there is limited customer protection risk for the retail public.

D. Proposed New Rule 4.23(c) – Recordkeeping Relief for U.S. Registered CPOs of Offshore Pools

The CFTC is proposing to add a new recordkeeping exemption for U.S. registered CPOs to offshore pools meeting the offshore pool requirements set out in proposed Rule 4.13(a)(4). Proposed Rule 4.23(c), as amended, would allow a qualifying, registered onshore CPO to maintain the original books and records of its offshore commodity pool(s) at the location of such pool(s), instead of requiring the CPO to maintain those books and records at its main business office in the U.S. The new exemption would effectively be a codification of the recordkeeping location relief provided in Staff Advisory 18-96, and would require the CPO to file a claim for exemptive relief with the NFA making the representations set forth in the new rule.

E. Permitting Non-U.S. Persons in *De Minimis* Commodity Pools under Rule 4.13(a)(3) Without Regard to Financial Sophistication

The CFTC is proposing to amend the *de minimis* exemption in Rule 4.13(a)(3) to remove a cross-reference in Rule 4.13(a)(3)(iii)(E) to rescinded Rule 4.13(a)(4) and replace it with “non-U.S. persons.” This amendment would explicitly permit persons located outside of the United States as exempt *de minimis* commodity pool participants, without consideration of their financial sophistication, and would incorporate in the rule relief provided in CFTC Letter No. 04-13, on which market participants currently rely. The Proposing Release states that:

With limited participation in U.S. commodity interest markets subject to Commission jurisdiction, commodity pools exempt under [Rule] 4.13(a)(3) do not trigger the same level of regulatory interest for the Commission as commodity pools requiring CPO registration and compliance with all or part of the requirements in 17 CFR part 4.¹⁸

F. Bona Fide Hedging

Rule 4.5, by its terms, currently excludes from the *de minimis* trading restrictions positions in commodity interests that “come within the meaning and intent of the definition of bona fide hedging transactions and positions for excluded commodities in §§ 1.3 and 151.5 of this chapter.” As originally amended in 2012, the definition of bona hedging in Rule 4.5 referred to CFTC Rules 1.3(z)(1) and 151.5, as those rules were in effect in February of 2012, when the amendments to Rule 4.5 were adopted.¹⁹ Those definitional rules were subsequently vacated by the U.S. District Court for the District of Columbia (in connection with litigation unrelated to Rule 4.5).²⁰ This created some legal uncertainty as to the effect of the incorporation of those regulations in the CFTC's amendments to Rule 4.5. On October 12, 2012, DSIO issued interpretative guidance providing that Rule 4.5(c)(2)(iii)(A) and (B) (the *de minimis* trading restrictions) continue to incorporate the substance of vacated Rules 1.3(z)(1) and 151.5 for purposes of those provisions only.²¹ In discussing the proposed amendments to Rule 4.5 relating to BDCs, the Proposing Release notes that the Commission is not at this time proposing to remove the cross-references in Rule 4.5 to the definitions of bona fide hedging in Rules 1.3(z)(1) and 151.5, but intends to consider amendments to the bona fide hedging definition in Rule 4.5 when it adopts final rules replacing the vacated regulatory provisions.²²

VII. Conclusion

In the press release announcing the Proposal, CFTC Chairman J. Christopher Giancarlo expressed the hope that this would be the first in a series of long-overdue simplifications to Part 4 regulations consistent with the goals of the Project KISS initiative, which sought public input on simplifying and modernizing the agency's regulations to make them less burdensome and costly, while maintaining their regulatory benefits. The KISS initiative, the Chairman's statement, and the Proposing Release all send a clear message underscoring the importance of public comment in developing sound regulation and serve as an invitation for the public to participate in the regulatory process. As the Chairman stated: “We look forward to working with the public to ensure these rules are adopted and implemented in an effective and transparent method.”

The CFTC's attention to CPO and CTA exemptions within the framework of the regulatory goals of Project KISS, together with its invitation for public participation, is a welcome development. While the Proposal has been widely described as a codification of existing relief for CPOs and CTAs, a closer look shows that the scope and potential impact of the Proposal, both in itself and as a foundational step for the reforms to come, may be far broader. The Proposal thus presents an important, and perhaps unique, window of opportunity for asset managers to play a constructive role in developing a regulatory framework that may govern their activities for decades.

¹ See [Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors](#); Notice of Proposed Rulemaking, 83 Fed. Reg. 52,902 (Oct. 18, 2018) (Proposing Release); [CFTC Proposes to Streamline Regulations for Commodity Pool Operators and Commodity Trading Advisors, CFTC Release No. 7825-18](#) (Oct. 9, 2018) (Press Release).

² See proposed Rule 4.13(a)(4)(i)-(v).

³ See the [Proposing Release](#) at 52,904, n. 22 (citing [Introducing Brokers and Associated Persons of Introducing Brokers, Commodity Trading Advisors and Commodity Pool Operators; Registration and Other Regulatory Requirements](#), 48 Fed. Reg. 35,248, 35,261 (Aug. 3, 1983) (Adopting Release)).

⁴ [CFTC Staff Advisory 18-96](#) (Apr. 11, 1996) currently provides limited relief from the Part 4 requirements for registered CPOs, including U.S. based CPOs, that operate offshore pools, and served as the CFTC's starting point for developing a new offshore pool exemption. The Proposing Release characterizes proposed Rule 4.13(a)(4) as an expansion of the relief provided by Staff Advisory 18-96 and refers to the proposed exemption as the "**18-96 Exemption**." Rule 3.10(c)(3)(i) is the CFTC's exemption for offshore CPO activities conducted by non-U.S. based, unregistered CPOs. In its current form, Rule 3.10(c)(3)(i) provides an exemption from CPO registration for persons located outside the U.S., its territories or possessions that are engaged in CPO activities only on behalf of persons located outside the U.S., its territories or possessions, in connection with any commodity interest transaction executed bilaterally or made on or subject to the rules of any designated contract market or swap execution facility. The relief provided by Rule 3.10(c)(3)(i) is self-executing, meaning that no claim for exemption must be filed by the CPO seeking to rely upon the exemption. The CFTC has proposed to amend Rule 3.10(c)(3)(i) to codify relief provided in two staff no-action letters. [Exemption from Registration for Certain Foreign Persons](#); Proposed Rule, 81 Fed. Reg. 51,824 (Aug. 5, 2016).

⁵ The requirement would also apply to the exemptions available under existing Rules 4.13(a)(1), (a)(2), and (a)(5), which are less commonly relied on than Rule 4.13(a)(3).

⁶ The Proposing Release states that the customer protection concerns arose in connection with certain statutorily disqualified CPOs operating commodity pools under the exemption previously available under now rescinded Rule 4.13(a)(4), which prior to 2012 provided a broad exemption for CPOs of certain private funds without a commodity interest trading or marketing restriction.

⁷ The text of sections 8a(2) and 8a(3) of the CEA can be

found here: <https://www.gpo.gov/fdsys/pkg/USCODE-2015-title7/html/USCODE-2015-title7-chap1.htm> (where sections 8a(2) and 8a(3) are codified at 7 U.S.C. 12a(2) and 12a(3)). Sections 8a(2) and 8a(3) of the CEA set forth two lists of circumstances relating to misconduct under which the CFTC may take adverse registration action (refuse to grant, condition, or in some cases suspend or revoke registration). Section 8a(2) identifies circumstances that generally involve more severe misconduct (financial fraud or theft) and for the most part are limited to a five- or ten-year period. The CFTC may refuse, condition, suspend or revoke registration based on any of these circumstances without a hearing. Section 8a(3) identifies a much broader set of circumstances that could form the basis for the CFTC to refuse or condition (but not revoke or suspend) registration, after notice and a hearing and a finding that one or more of the circumstances exists. These circumstances are set forth in fourteen paragraphs, including a catchall provision (if "there is other good cause"), and generally do not impose a time cut-off on when the conduct occurred. Regardless of whether the CFTC decides to adopt the new condition, it would be helpful to clarify that the circumstances described in section 8a(3) are not statutory disqualifications until there is a CFTC finding to that effect.

⁸ These exemptions would be Rule 4.14(a)(4), for a CTA serving as the pool's registered CPO, and Rule 4.14(a)(5), for a CTA serving as the pool's exempt CPO.

⁹ The two staff exemptive letters proposed to be codified are [CFTC Letter No. 14-115](#) (Sept. 8, 2014) (exempting from the CPO-PQR filing requirement any CPO operating only exempt pools), and [CFTC Letter No. 15-47](#) (July 21, 2015) (exempting from the CTA-PR filing requirement any CTA that does not direct the trading of any commodity interest accounts). The proposed amendment would expand the filing relief provided by these letters to include CTAs described in paragraph (2)(b) above.

¹⁰ See SEC Rule 202(a)(11)(G)-1. A family office is generally understood to be a professional organization that is wholly owned by clients in a family, including members of a family and/or entities controlled by a family or family member, for example, charitable trusts, and that is operated as a wealth management tool for their benefit. The operations of a family office often involve the collective management of pooled assets from members of the same family, or organizations, trusts, or foundations for the benefit of those family members. The Proposing Release states that if the managing member of the family office, or similarly situated persons providing services to the family office, invests such pooled assets in commodity interests, then it is highly likely that this person is engaging in activities that would otherwise require registration with the CFTC as a CPO or CTA.

¹¹ [CFTC No-Action Letter No. 12-37](#) (Nov. 29, 2012) (registration relief for family office CPOs), and [CFTC No-Action Letter No. 14-143](#) (Nov. 5, 2014) (registration relief for family office CTAs).

¹² With respect to providing CTA services to the family office (as opposed to family clients), the CFTC preliminarily believes that a family office claiming a CPO registration exemption under proposed Rule 4.13(a)(8) would be able to rely on Rule 4.14(a)(5) for an exemption from CTA registration.

¹³ The Proposing Release cites two staff letters that took the “not a pool” approach to family offices. See [CFTC Staff Letter No. 00-100](#) (Nov. 1, 2000), and [CFTC Staff Letter No. 97-78](#) (Sept. 24, 1997), cited in the Proposing Release in note 53.

¹⁴ See [Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations](#); Final Rule, 77 Fed. Reg. 11,252, 11,259 (Feb. 24, 2012). As a result of the 2012 amendments to Rule 4.5 that imposed commodity interest trading and marketing restrictions as conditions of relying on Rule 4.5 with respect to Registered Funds, a number of Registered Funds could no longer rely on the Rule 4.5 exclusion, and their operators were required to register as CPOs. In that context, the CFTC determined that the Registered Fund’s investment adviser, rather than its Board of Directors or Trustees, was the appropriate person to serve as the Registered Fund’s registered CPO.

¹⁵ See [CFTC Letter No. 12-40](#) (Dec. 4, 2012). BDCs are closed-end management investment companies that are created by, and subject to regulation under, the ICA, but are not Registered Funds; rather they are entities exempt from registration under the ICA by virtue of the filing of an election to be treated as a BDC under section 54 of the ICA, which imposes on BDCs that make such an election many regulatory requirements similar to those applicable to Registered Funds. Because BDCs are not Registered Funds, the Rule 4.5 exclusion for Registered Funds and their advisers is not available to BDCs.

¹⁶ See [Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings](#), 77 Fed. Reg. 54,464 (Sept. 5, 2012) (Proposing Release), and 78 Fed. Reg. 44,771 (Jul. 24, 2013) (Adopting Release).

¹⁷ See [CFTC Letter No. 14-116](#) (Sept. 9, 2014).

¹⁸ See the [Proposing Release](#) at 52,907.

¹⁹ See current Rule 4.5(c)(2)(iii).

²⁰ See *Int’l Swaps & Derivatives Ass’n v. CFTC*, 887 F. Supp. 2d 259 (D.D.C. Sept. 28, 2012).

²¹ See [CFTC Staff Letter 12-19](#) (Oct. 12, 2012).

²² See the [Proposing Release](#) at 52,912, n. 135.



Ruth S. Epstein



Peter M. Hong



John M. Ekblad



Nicole Simon

For more information, contact Ruth S. Epstein at 202.292.4522 or repstein@stradley.com, Peter M. Hong at 202.419.8429 or phong@stradley.com, or John M. Ekblad at 312.964.3506 or jekblad@stradley.com, or Nicole Simon at 212.812.4137 or nsimon@stradley.com.