

CLIENT ALERT

CFTC Proposes to Codify Prior Relief for CPOs and CTAs

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The Commodity Futures Trading Commission yesterday proposed rules to make permanent certain of the no-action, exemptive and advisory relief provided to commodity pool operators and commodity trading advisors over the years. As part of its Project KISS initiative, the CFTC has sought, among other things, to simplify the application of its rules for registrants and other market participants. Codifying relief, especially in areas where the CFTC and its staff have developed knowledge through experience, advances that goal. Highlights of the proposed rules follow.

Advisory 18-96 morphs into new Rule 4.13(a)(4)

Published in April 1996, CFTC Advisory No. 18-96 instituted a standardized mechanism for registered CPOs of non-U.S. investment vehicles to claim relief from many of the requirements otherwise applicable to registered CPOs. Prior to Advisory 18-96, CFTC staff provided similar relief on a case-by-case basis. Currently, upon the filing of a self-executing notice, the CPO of an Advisory 18-96 pool is exempt from all of the disclosure and many of the reporting and recordkeeping obligations that otherwise would apply to such CPO.

Advisory 18-96 and proposed Rule 4.13(a)(4) include several requirements with respect to the pool. The pool must (i) be organized and operated outside of the United States; (ii) not hold meetings or conduct administrative activities within the United States; (iii) have no shareholder or other participant that is, or will be, a United States person as defined in CFTC Rule 4.7; and (iv) not receive, hold or invest any capital directly or indirectly contributed from sources within the United States. In addition, marketing activities with respect to the pool must avoid solicitation of U.S. persons.

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Family Offices

CFTC No-Action Letters 12-37 and 14-143 provide relief from registration, respectively, for CPOs and CTAs of family offices. To perfect the relief, a family office must submit a claim to the CFTC Division of Swap Dealer and Intermediary Oversight (DSIO) and remain in compliance with the exclusion for family offices from the definition of investment adviser, adopted by the Securities and Exchange Commission in 2011.

The CFTC proposes to exempt from registration (i) CPOs of pools offered privately to family clients; and (ii) CTAs who advise family clients. “Family client” would be defined by reference to SEC Rule 202(a)(11)(G)-1.¹ Family offices would be required to make a filing with the National Futures Association in order to claim this family office exemption.

JOBS Act Consistency

CFTC Exemptive Letter 14-116 provides relief from certain provisions of CFTC Rules 4.7(b) and 4.13(a)(3), which restrict marketing to the public. The letter was issued to harmonize these CFTC rules with SEC Rule 506(c) of Regulation D and SEC Rule 144A, which permit general solicitation or advertising, subject to specific conditions. The SEC rules were amended pursuant to the Jumpstart Our Business Startups Act of 2012 (aka the JOBS Act). CPOs currently wishing to rely upon this exemptive letter, among other things, must file a notice with DSIO.

The CFTC proposes to revise the relevant provisions of Rules 4.7(b) and 4.13(a)(3) to eliminate the language that restricted marketing the pool to the public. Advertising undertaken with respect to any such pool must comply with the provisions of either Reg. D or Rule 144A.

Business Development Companies

CFTC No-Action Letter 12-40 relieves the operator of a business development company (BDC) from the requirement to register with the CFTC as a CPO, subject to certain conditions. BDCs that engage in swap transactions were brought within the scope of the Commodity Exchange Act (CEA) as a result of Dodd Frank’s inclusion of swaps in the definition of commodity interest. In addition to filing a notice with DSIO, the BDC must comply with *de minimis* trading thresholds similar to those that appear in CFTC Rule 4.5 for registered investment companies (RICs). The BDC must elect to be treated as a BDC under the Investment Company Act of 1940. Finally, the BDC may not be marketed as a commodity pool or otherwise as a vehicle for trading in commodity interests.

¹ The SEC defines “family client” generally to include current and former family members and their estates, certain family office employees, charities funded by family clients, trusts funded by or existing for the benefit of family clients, and companies owned exclusively by, and operated for the sole benefit of, family clients.

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The CFTC proposes to add BDCs to the category of investment vehicles in Rule 4.5 whose operator may claim exclusion from the definition of CPO. In connection with this proposal, Rule 4.5 would also be amended to specifically identify the investment adviser to a BDC or RIC as the CPO.

PQR and PR Reporting Relief

CFTC Exemptive Letter 14-115 exempts CPOs that are registered, but that operate solely Rule 4.5 and/or Rule 4.13(a)(3) pools, from the requirement to report on Form CPO-PQR. Similarly, CFTC Exemptive Letter 15-47 exempts CTAs that are registered, but do not direct any client accounts, from the requirement to report on Form CTA-PR. DSIO observed that such filings would provide limited additional information regarding such CPOs and CTAs beyond that already available to the Commission as part of the registration process and ongoing obligations to which CPOs and CTAs are subject.

The CFTC proposes to amend the definition of “reporting person” in Rule 4.27. Any registered CPO that operates only pools for which it is excluded or exempt from registration would be relieved from the obligation to file Form CPO-PQR. Similarly, any registered CTA that advises solely its own commodity pools or has no discretion at all over client accounts, would be relieved from the obligation to file Form CTA-PR.

Non-U.S. Investors

The CFTC proposes specifically to include non-U.S. persons within the categories of participants permitted to invest in Rule 4.13(a)(3) pools, thus eliminating the need for CPOs to rely on Staff Letter 04-13 (aka Fred’s letter) and other staff guidance.

Statutory Disqualification

The CFTC proposes to subject most claims of exemption under Rule 4.13 to the prohibition on statutory disqualification that is currently contained in Advisory 18-96. The CEA’s disqualification provisions permit the CFTC to refuse to register or condition the registration of persons who have engaged in certain bad acts. Family office CPOs would not be subject to the statutory disqualification provision.

Recordkeeping

Among other changes, the CFTC proposes to import into Rule 4.23 the recordkeeping provisions currently appearing in Advisory 18-96. Advisory 18-96 permits a U.S. domiciled CPO to maintain the records of its offshore pool in a non-U.S. location, subject to certain conditions.

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