

Alert

CFTC Amendments to Registration and Compliance Rules — Lessons for Private Fund Managers

December 17, 2019

On Nov. 25, 2019, the Commodity Futures Trading Commission approved amendments¹ that impact several registration and reporting exemptions, which will affect many hedge fund and private equity fund managers. While, in general, these are long-needed changes that streamline administrative processes or harmonize CFTC rules with those of other regulators or with actual market practice, every private fund manager relying on a CFTC exemption should review the details of the changes.

Rule 4.13 “Qualified Eligible Person” and “Non-United States Person” Updates

Many private fund managers rely on the Regulation 4.13(a)(3) “de minimis” exemption from CFTC registration as a commodity pool operator. Among other requirements, Rule 4.13(a)(3) requires that each participant in a qualifying pool fall into one of the following categories:

- An “accredited investor” as defined in Rule 501 under the Securities Act of 1933 (or a trust that was formed by an accredited investor for the benefit of a family member);
- A “knowledgeable employee” as defined in Rule 3c-5 under the Investment Company Act of 1940; or
- Certain categories of “qualified eligible persons” listed in CFTC Rule 4.7(a)(2)(viii)(A).

The November 2019 amendment expanded the qualified eligible person prong to include *any* qualified eligible person (and not just those listed in clause (a)(2)(viii)(A) of Rule 4.7). This change removed needless complexity and also ratified “the general market practice” of permitting non-United States persons (a non-United States person is, by definition, a qualified eligible person, but is not one listed in CFTC Rule 4.7(a)(2)(viii)(A)) to invest in Rule 4.13 pools. It also clarified that Rule 4.7’s definition of “non-United States person” (which includes a natural person who is not a resident of the United States, estates and trusts outside of U.S. income tax jurisdiction, business associations organized for passive investment located outside of the United States, passive investment vehicles that have under 10% U.S. ownership, and non-U.S. pension plans) should also be used for this purpose.

No Replacement for Advisory 18-96

The CFTC’s amendments were widely expected to contain a codification of Advisory 18-96 relief, which provides reporting, disclosure and recordkeeping relief to registered operators of commodity pools with

¹ See “CFTC, Registration and Compliance Requirements for Commodity Pool Operators (CPOs) and Commodity Trading Advisors: Family Offices and Exempt CPOs” (Nov. 25, 2019), [available here](#); See also CFTC, Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors: Registered Investment Companies, Business Development Companies, and Definition of Reporting Person (Nov. 25, 2019), [available here](#).

no U.S. administration, marketing or sources of income. The CFTC had proposed replacing Advisory 18-96 with a new Regulation 4.13(a)(4), which would have offered a full exemption from CPO registration (and thus reporting on Form CPO-PQR, which remains an obligation under Advisory 18-96 relief). The CFTC has withdrawn this proposal, although it notes that it may revisit the subject in the future.

Family Office Exemption Claims

Family offices that engage in commodity interest trading have been able to rely on two CFTC no-action letters, 12-37 and 14-143, to avoid registering with the CFTC and the National Futures Association as commodity pool operators or commodity trading advisors. New Rule 4.13(a)(6) and new Rule 4.14(a)(11) substantially codify the CFTC's older CPO and CTA no action relief but, notably, neither of the new exemptions requires any filing with the NFA or CFTC (which was the case with the no-action letters).

- New Regulation 4.13(a)(6) provides an exemption from CPO registration for a person with respect to a qualifying commodity pool if: (a) interests in the pool are exempt from registration under the Securities Act, and such interests are sold only to "family clients" (as defined in Securities Act Rule 202), (b) the commodity pool qualifies as a "family office" (also as defined in Rule 202) and (c) the person reasonably believes, at the time of investment, that each person who participates in the pool is a "family client" of the "family office."
- New Regulation 4.14(a)(11) provides an exemption from CTA registration to a person who directs commodity trading advice solely to (and for the sole use of) "family clients."

Regulations 4.13(a)(6) and 4.14(a)(11) will supersede No Action Letters 12-37 and 14-143 (although not prior staff letters determining that a particular entity is "not a pool").

Legal and compliance personnel for private fund managers whose principals have family offices (or who are planning to start a family office) should be aware that, although neither of the new rules requires a notice filing to be effective, the CFTC has guided that qualifying family offices should create and maintain an internal record that documents their intent to claim relief under either of these rules, including their qualifications for these exemptions.

All managers that are registered with the CFTC will also need to plan on reviewing and revising their NFA Bylaw 1101 questionnaires to reflect the CFTC's new rules and documentation requirements for family offices.

General Solicitation Under § 506(c)

The CFTC's November amendments also harmonized Rule 4.13(a)(3) and Rule 4.7 pool investments with offerings conducted under the SEC's Rule 506(c), which allows certain general solicitation activities for unregistered securities; provided that accredited investor verification efforts are undertaken.²

Prior to these amendments, managers of Rule 4.13 or Rule 4.7 pools that were engaging in a 506(c) offering had to rely on CFTC no-action letter 14-116, which required a notice filing. The November amendments clarify that:

² See "Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings," 77 FR 54464 (Sept. 5, 2012) and 78 FR 44771 (Jul. 24, 2013) ("JOBS Act Adopting Release") (amending Regulation D, 17 CFR 230.500-230.508, and Rule 144A, 17 CFR 230.144A).

- Rule 4.7's prohibition on marketing to the public does not apply to a registered CPO that offers or sells participations in a pool offered pursuant to Rule 506(c);
- The relief under Rule 4.7(b) is available to otherwise eligible pools, even if participations in such pools are resold under Rule 144A; and
- The marketing and advertising of interests in Rule 4.13(a)(3) (de minimis) pools to the public is permissible if done in compliance with Rule 506(c) or Rule 144A.

No further action is required for firms that have already filed the notice required by that Letter. CPOs interested in using general solicitation with respect to future pools that qualify for Regulation 4.7 or 4.13(a)(3) will need to furnish the standard NFA notices required by those exemptions.

Form CPO-PQR and CTA-PR Exclusions for Reporting Persons

The CFTC's new amendments to Regulation 4.27(b) substantively codify its prior no action letters 14-115 and 15-47, which provided relief from reporting:

- On Form CPO-PQR, for CPOs that exclusively operate Regulation 4.13(a)(3) pools or pools subject to a definitional exclusion under Regulation 4.5; and
- On Form CTA-PR, for CTAs that are registered, but are not yet directing client accounts.

Additionally, the CFTC's amendments to Regulation 4.27(b) extend Form CTA-PR reporting relief to CTAs that comply with the CTA registration exemptions in Regulation 4.14(a)(4) (where the CTA is already registered as a CPO), and Regulation 4.14(a)(5) (where the CTA is exempt from CPO registration), but are nevertheless registered as CTAs. In the first case, the CFTC has deemed further Form CTA-PR reporting to be duplicative of information already being provided on Form CPO-PQR, and in the latter case, incongruent with lack of a requirement to provide Form CPO-PQR at all. No notice filing is required to take advantage of the amended relief in Regulation 4.27(b).

Authored by [Brian T. Daly](#) and [Joshua B. Wright](#).

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

Schulte Roth & Zabel
New York | Washington DC | London
www.srz.com

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