Alert

CFTC Provides Additional Delegation Relief for Private Fund Managers

November 10, 2014

On Oct. 15, 2014, the staff of the Commodity Futures Trading Commission issued a letter granting no-action relief to persons seeking to delegate their commodity pool operator authority to others.\(^1\)

The October letter expands upon the relief granted in an earlier (May 2014) letter\(^2\) in two respects:

- Unlike the May letter, the October guidance provides *self-executing* relief (i.e., no application need be made, and no notice is required to be filed with the CFTC); and
- The October letter also addresses some technical, but often problematic, impediments to accessing the relief granted through the May letter.

**Conditions for Relief**

**Historical Practice.** The CFTC staff historically has considered the general partner or managing member of a commodity pool (such as a hedge fund) and each member of its board of directors to be a commodity pool operator (a “CPO”);\(^3\) however, it is generally the investment manager (which may also be an SEC-registered investment adviser) of a private fund that carries out all or substantially all of the responsibilities that the CFTC regulations ascribe to the CPO.

With these two letters, the CFTC staff now allows certain persons that it classifies as CPOs (“Delegating CPOs”) to delegate their CPO authority, without any additional notice or claim, to others (“Designated CPOs”), provided that the Delegating CPO and the Designated CPO satisfy certain conditions.

**The May 2014 Relief.** In the earlier May letter, the staff set forth several eligibility criteria for a delegation of CPO authority, including the following:

- The Delegating CPO must have delegated all investment management authority to the Designated CPO;
- The Delegating CPO may not manage any property of the commodity pools for which it has delegated its CPO authority;

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1 CFTC Staff Letter 14-126.

2 See CFTC Staff Letter 14-69. See also our Alert addressing that earlier guidance, “CFTC Provides Guidance Regarding Commodity Pool Operator Delegation — Action Required for Many Registered CPOs.”

3 For a more detailed discussion of the CFTC’s historical practice, see our Alert, “CFTC Provides Guidance Regarding Commodity Pool Operator Delegation — Action Required for Many Registered CPOs.”
The Delegating CPO may not engage in any solicitation of participants for the commodity pools for which it has delegated its CPO authority;

The Delegating CPO may not be subject to a statutory disqualification;

There must be a business purpose for the Delegating CPO’s separate entity status (other than a desire to avoid registration);

The Designated CPO must maintain its books and records in compliance with CFTC Regulation 1.31;

Where both are non-natural persons, each of the Delegating CPO and the Designated CPO must control, be controlled by, or be under common control with the other; and

The Delegating CPO and the Designated CPO must agree to continue to remain jointly and severally liable for violations of the Commodity Exchange Act (not required for “unaffiliated board members”).

The October 2014 Relief. Following the issuance of the May 2014 letter, the CFTC staff received “a large number of requests” under the May letter’s streamlined approach, which apparently surpassed their ability to process in a timely manner. In addition, many industry participants pointed out issues with certain substantive or procedural aspects of the May letter, which the staff found “sufficiently prevalent to warrant further clarification.”

The October letter provided additional relief by clarifying several of the May criteria:

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<tr>
<th>May 2014 Requirement</th>
<th>Industry Concern</th>
<th>October 2014 Clarification</th>
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<td>The Delegating CPO must have delegated all investment management authority to the Designated CPO.</td>
<td>In some situations, a Delegating CPO or a Designated CPO has engaged a third party to manage a portion or all of a pool’s investments.</td>
<td>The CFTC staff clarified that this requirement does not preclude either the Delegating CPO or the Designated CPO from hiring a third-party investment manager. 4</td>
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<td>The Delegating CPO may not engage in any solicitation of participants for the commodity pools for which it has delegated its CPO authority.</td>
<td>Associated persons of a CPO often serve as “insider” directors of (and solicit investors for) pools managed by the CPO.</td>
<td>The CFTC staff clarified that this requirement would not preclude allowing such directors from soliciting for the fund.</td>
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<td>The Delegating CPO may not manage any property of the commodity pools for which it has delegated its CPO authority.</td>
<td>CPOs often place their chief investment officers (or similar senior personnel) on the boards of their managed pools as “insider” directors.</td>
<td>The CFTC staff clarified that this requirement would not preclude such directors from managing property of the pool.</td>
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<td>The Designated CPO must maintain its books and records in compliance with CFTC Regulation 1.31.</td>
<td>Regulation 1.31 contains outdated technical requirements for electronic books and records maintenance that present significant compliance challenges.</td>
<td>The new guidance — while framed as a “clarification” — effectively supplants the May requirement with a simple requirement that the books and records of the Delegating CPO with respect to the commodity pool be maintained by the Designated CPO.</td>
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The rest of the criteria remain the same as in the previous guidance.

4 Note that such a third-party manager would need to be registered as a commodity trading advisor or be exempt from registration.
Conditions for Relief
Delegating CPOs who meet the conditions of the most recent guidance (as well as CPOs who have previously received relief from CFTC staff) need to take no further steps with the CFTC. While this means that the CFTC staff will no longer be looking at relief requests submitted pursuant to CFTC Letter 14-69, CFTC staff will continue to evaluate new delegation relief requests from Delegating CPOs who fall outside the scope of this most recent guidance.

Authored by Brian T. Daly and Jacob Preiserowicz.

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

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5 There is still the possibility that the National Futures Association may implement some form of notice filing requirement for Delegating CPOs (or for Designated CPOs, on behalf of the Delegating CPOs).