Do Your Derivatives Trading Activities Require You To Be Registered As a Commodity Pool Operator by 1 January 2013?

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Commodity Pool Operator
and Commodity Trading Advisor
Definitions
Commodity Pool Definition

- Commodity Pool: the statutory term for a fund or other pooled vehicle that invests in futures contracts (including security futures), options on futures contracts, swaps leverage contracts, retail forex and/or other retail commodity transactions (collectively “commodity interests”)

- A collective investment vehicle that does not trade commodity interests directly, but only indirectly through another pool, is also deemed a commodity pool (“fund-of-funds”)
Commodity Pool Definition (cont’d)

- Swaps involve an agreement, contract or transaction based upon an exchange of payments tied to a notional amount of an asset, index or rate

- Swaps also include options on physical commodities, so-called “event” contracts, and “mixed” swaps

- For currency-related instruments, if there is an exchange of currencies, the instrument will likely be exempt from swap definition
  - However, if settlement is in a single currency like dollars, such as in the case of “non-deliverable forwards,” the instrument will likely be classified as a swap

- Security-based swaps, generally swaps on a single security or a narrow-based index, are not swaps and not included – contrast with security futures
CPO vs. CTA

- The Commodity Exchange Act ("CEA") regulates the operator of a commodity pool, as opposed to the pool itself.
- Each commodity pool has at least one CPO and one CTA, although this may be the same entity.
- Each commodity pool may also have multiple CPOs and/or CTAs.
Definition of CPO

- CPO is someone who operates a commodity pool and who solicits investors with regards to that pool
  - Often the managing member or general partner
    - An SPV that acts as general partner may delegate management functions to a registered CPO and be relieved of CPO registration under certain conditions
  - In a corporate structure (like a Cayman Islands exempted company), most likely the directors unless delegation of management functions is made to the investment manager
  - Solicitation of investors often outsourced to a broker-dealer
- The CFTC, through a series of orders and no-action relief, has delayed the effective date of the Dodd-Frank changes to the definition of CPO until year-end
Definition of CTA

- CTA is someone who provides trading advice with respect to commodity interests
  - In a fund that has no separate investment adviser, the general partner/managing member is both CPO and CTA
  - In a corporate structure, the directors are usually the CPOs unless delegation is made to the adviser, and the adviser is the CTA
  - In a separate account, the investment adviser is the CTA; there is no CPO
- Title VII of Dodd-Frank amended the definition of CTA to, among other things, include swaps
- The CFTC, through a series of orders and no-action relief, has delayed the effective date of the Dodd-Frank changes to the definition of CTA until year-end
Rescission of CFTC Regulation 4.13(a)(4) and Revised CFTC Regulation 4.13(a)(3)
Rescinded Exemption for Pools with Highly Sophisticated Investors

- On 8 February 2012, the CFTC rescinded CFTC Regulation 4.13(a)(4) (effective 24 April 2012), which contained a broad exemption from most of the requirements of the CEA.
- CFTC Regulation 4.13(a)(4) generally required investors to meet the “qualified purchaser standard” or be “non-United States persons.”
- CFTC Regulation 4.13(a)(4) did not contain any limit on the amount of a pool’s trading in commodity interests.
- CFTC Regulation 4.13(a)(4) required:
  - A filing claiming the exemption to be made with the National Future Association (“NFA”)
  - That fund investors receive disclosure stating that the CPO relies on the exemption.
Rescinded Exemption for Pools with Highly Sophisticated Investors (cont’d)

- As a result of the rescission of CFTC Regulation 4.13(a)(4), many private fund managers will be forced to either comply with CFTC Regulation 4.13(a)(3), register as a CPO (in addition to being registered with the U.S. Securities and Exchange Commission (“SEC”)), or exit the commodity interest markets.
- CFTC Regulation 4.7 may return to prominence
  - Only available to registered CPOs
  - Requires that quarterly and annual reports are sent to investors
  - Requires that annual reports are filed with the NFA
  - Investors must meet the qualified eligible person (“QEP”) standard
CFTC Regulation 4.13(a)(3) Conditions

- Pool interests exempt from Securities Act of 1933 ("Securities Act") registration
- No marketing to the public in the United States or as a vehicle for trading commodity interests
  - Impact of JOBS Act on CFTC Regulation 4.13(a)(3) pool offerings
- Investors must be “accredited investors,” family trusts, “knowledgeable employees,” QEPs, certain persons associated with the CPO and “Non-United States persons”
- Must file notice annually
Trading Limitations – 5% Test

- Aggregate initial margin and premiums required to establish commodity interest positions may not exceed 5% of the “liquidation value” of the fund’s portfolio, taking into account unrealized profits and unrealized losses.
- Liquidation value is net of the amount borrowed or net asset value (58 Fed. Reg. 6371 (28 January 1993))
Trading Limitations – Notional Test

- Aggregate net “notional value” of commodity interest positions may not exceed 100% of the liquidation value of the fund’s portfolio, taking into account unrealized profits and unrealized losses.

- Especially useful alternative to the 5% Test because margin levels for broad-based stock index futures and security futures tend to exceed levels for other commodity interests, which may make it difficult to satisfy the 5% Test.
Trading Limitations – Notional Test (cont’d)

- Notional value determined by asset class:
  - For futures contracts, multiply the number of contracts by the size of the contract, in contract units (taking into account the multiplier in the contract), by the current market price per unit
  - For options, multiply the number of contracts by the size of the contract, adjusted by the delta, in contract units (taking into account the multiplier specified in the contract)
  - For cleared and uncleared swaps, the value as reported pursuant to the CFTC’s Part 45 regulations – notional amount

- Netting determined by asset class:
  - For futures contracts and options on futures contracts, net across designated contract markets or foreign boards of trade
  - For cleared swaps, net if cleared by the same derivatives clearing organization and “where appropriate”
  - Not permitted for uncleared swaps
De Minimis Tests – Other Matters

- Does a fund have to satisfy the 5% Test or the Notional Test every day?

- What about inadvertent, temporary failures to meet the 5% or Notional Tests?

- Difficult for funds-of-funds to comply with either de minimis test because it would require monitoring trading activities of underlying managers

- Status of Appendix A
Non-U.S. Managers

- Exemption from registration under CFTC Regulation 3.10(c)(3) is available if fund is non-U.S., CPO is non-U.S., all investors are located outside of the U.S. and no solicitations are directed into the U.S.

- Trading must be conducted on non-U.S. exchanges; bilaterally with non-U.S. counterparties for swaps; or on U.S. exchanges, or bilaterally with U.S. counterparties for swaps, and submitted for clearing through a registered futures commission merchant ("FCM")
Transition from Exempt to Registered Status
Launching a New Fund Immediately

- On 13 July 2012, CFTC published staff letter 12-03, permitting the launching of new funds from that date through 31 December 2012 under the same conditions as rescinded CFTC Regulation 4.13(a)(4)
- This no-action relief is not self-executing – to claim it, you must:
  - File a notice stating (1) the name, main business address and main business telephone number of the company making the claim, and (2) that relief from CPO registration is being claimed
  - The notice must be electronically signed and sent to the email address dsionoaction@cftc.gov
Registration Considerations

- It is important to file the registration application as soon as possible so that, if NFA raises any issues, they can be timely resolved.

- If you have previously filed a notice claiming exemption under CFTC Regulation 4.13(a)(4), registration will not become effective until 1 January 2013, unless you request otherwise.

- Unless you intend to transition to CFTC Regulation 4.13(a)(3), do not request rescission of exemption notices under CFTC Regulation 4.13(a)(4) as NFA will automatically rescind them on 31 December 2012.
Registration Considerations (cont’d)

- Please do file your registration application as soon as you can, so that you may file your CFTC Regulation 4.7 notice in advance of registration taking effect on 1 January 2013.

- You may still request the 1 January 2013 effective date, even if you have no exemption notice on file – this may be of particular help to persons only claiming the no-action relief under CFTC Staff Letter 12-03.

- If a pool or account will use swaps, you must indicate that you are a “swap firm” on Form 7-R.
Registration as a CPO and/or a CTA
Registration as CPO and/or CTA

- The CPO/CTA and its associated persons (“APs”) must register as such under the CEA
- The CPO/CTA must also become a member of NFA and its APs must become associate members of NFA
- NFA handles registration processing on behalf of CFTC
- Applicants for registration as a CPO/CTA and membership in NFA must file Form 7-R and must submit a Form 8-R for each AP and natural person principal
**APs & Principals: Definitions and Responsibilities**

- If an entity is registered as a CPO or CTA, its “principals” and “associated persons” must be identified.

- **Who is a “principal”?**
  - Anyone with controlling influence, such as directors and officers.
  - Anyone with certain titles (regardless of ownership or controlling influence), including Director, President, CEO, COO, CCO, CFO for corporations, LLCs and LPs, general partner for LPs and manager and managing member for LLCs and LLPs.
  - Any natural person who owns 10% or more of the voting securities or contributed 10% or more of the capital.
  - Any entity that owns 10% of shares or contributed 10% or more of the capital.
  - Any person in charge of a principal business unit, division or function subject to CFTC regulation.

- **Consequences of being a “principal”?**
  - Unlike “AP” status, being listed as a “principal” does not entail any test-taking requirement but does require each natural person “principal” to file a Form 8-R with a fingerprint card for purposes of fitness screening.
APs & Principals: Definitions and Responsibilities (cont’d)

- Who is an “AP”? 
  - Natural person involved in soliciting funds, securities or property for participation in a commodity pool or opening a discretionary commodity interest trading account
  - As well as supervisors of such persons, even if those supervisors do not personally solicit
  - Does not have to be employed solely by the CPO/CTA; may have multiple sponsors
    - Each sponsor must accept joint and several liability for common customers
  - Someone may be both a principal and an AP
- At least one person must be both a principal and an AP
APs & Principals: Definitions and Responsibilities (cont’d)

Consequences of being an “AP”? 
- Registration on Form 8-R
- Fingerprint card
- Ethics training required by CFTC rules
- Oversight requirements
- Series 3 exam
  - Exam requirement may be avoided or waived if:
    - AP has passed Series 3 within previous 2 years; or since having passed the exam, there has not been a period of 2 consecutive years in which the AP was not registered as an AP or as a floor broker
    - AP had passed Series 3, took advantage of registration exemptions for CPOs since 2003 and withdrew AP registration as a result of employer’s reliance on CFTC Regulation 4.13(a)(4), but remained in the business
NFA’s Director of Compliance may grant waivers from the Series 3 examination requirement to individuals associated with CPOs if:

- The CPO or the pool is subject to regulation by a federal or state regulator, or the pool is privately offered pursuant to an exemption from the registration requirements of the Securities Act, and the CPO limits itself to operating a pool that: (1) engages principally in securities transactions, (2) commits only a small percentage of its assets as initial margin deposits and premiums for futures and options on futures, and (3) uses futures and options on futures only for hedging or risk management purposes; or

- The individual requesting the waiver is a general partner of a CPO or a pool that is primarily involved in securities investments; there is at least one registered general partner of the CPO or pool who has taken and passed the Series 3 examination; and the person requesting the waiver is not involved in soliciting or accepting pool participations, trading futures or options, handling customer funds, or supervision of these activities or engaging in any other activity that is integral to the operation of the fund as a pool.
APs & Principals: Definitions and Responsibilities (cont’d)

- NFA’s Director of Compliance may grant waivers from the Series 3 examination requirement to individuals associated with CTAs if:
  - The CTA is subject to regulation by a federal or state regulator;
  - The CTA’s futures and options trading advice to each of its clients is incidental to its securities advice; and
  - The CTA’s futures and options trading advice is only for hedging or risk management purposes

- Persons who are registered in the U.K. or Canada may be able to pass Series 32, in lieu of Series 3, depending upon the types of non-U.S. examinations passed
Examination waiver available for APs of CPOs that, but for swaps, could rely on CFTC Regulation 4.13(a)(3)

Examination not required for APs of CPOs and CTAs that just trade swaps
Branch Offices/Managers

- Branch office: Any location, other than the main business address, at which a CPO or CTA employs persons engaged in activities requiring AP registration

- Even if only 1 employee

- Need a branch office manager (Series 30) and branch office supervision procedures
CPO/CTA Compliance Obligations

Disclosure Document (if relief not available under CFTC Regulation 4.7)

- See CFTC Regulations 4.21, 4.24, 4.25 and 4.26 for CPOs and CFTC Regulations 4.31, 4.34, 4.35 and 4.36 for CTAs

- Past performance disclosure rules
  - If pool has less than a 3-year operating history, performance information must be supplied for other persons and entities (in addition to performance information for the offered pool), including the performance of other pools and managed accounts operated or traded by the CPO/CTA and the trading manager of the offered pool
CPO/CTA Compliance Obligations (cont’d)

- Disclosure document must be distributed to each prospective pool participant/client
- Disclosure document must be filed with the NFA, pre-cleared by the NFA and updated every 9 months

Reporting to Both NFA and Investors
- CPOs must furnish to each pool participant certain prescribed reports

Recordkeeping
- A CPO or CTA must keep, at its main business office, accurate books and records regarding each pool/client account it operates/advises
- Records are subject to inspection by the CFTC, the NFA, and the U.S. Department of Justice
Exemption from CPO Compliance Obligations for Registered CPOs
Exemption for Persons Who Operate Pools Composed Solely of “QEPs”

- CFTC Regulation 4.7(b) provides an exemption from almost all the disclosure, reporting, and recordkeeping requirements otherwise applicable to registered CPOs.
- However, this exemption is available only to a registered CPO, and only with respect to a pool composed solely of persons that the CPO “reasonably believes” are QEPs.
- Under CFTC Staff FAQ, do not need to requalify existing investors.
- Furthermore, the pool must be sold in an offering exempt from the registration requirements of the Securities Act pursuant to Section 4(2) (for example, under Rule 506 of Regulation D) or Regulation S.
- These pools may not be marketed to the public.
  - Do CFTC Regulation 4.7 “exempt” pools survive the JOBS Act?
Exemption for Persons Who Operate Pools Composed Solely of “QEPs” (cont’d)

- The definition of QEP is contained in CFTC Regulation 4.7(a)(2) and (a)(3)
  - CFTC Regulation 4.7(a)(2) identifies persons who do not need to meet the “Portfolio Requirement” to be QEPs (certain institutional investors)
  - CFTC Regulation 4.7(a)(3) identifies persons who must meet the “Portfolio Requirement”
- Because “qualified purchasers,” “knowledgeable employees” and “non-United States persons” are defined as QEPs without having to meet the “Portfolio Requirement,” the eligibility requirements for Section 3(c)(7) of the Investment Company Act of 1940 and CFTC Regulation 4.7(b) funds are the same
A QEP also includes an “accredited investor” that meets the “portfolio requirement”

Under CFTC Regulation 4.7(a)(1)(v), “portfolio requirement” means that a person must:

- Own securities
- (including pool participations) of unaffiliated issuers with an aggregate market value of at least $2 million
- Have had on deposit with an FCM at least $200,000 in exchange-specified initial margin and option premiums, together with the required minimum security deposit for retail forex transactions for commodity interest transactions or
- A combination of the above that adds up to 100%
CPOs who operate under this exemption have:

- No specific disclosure document requirements other than a legend and the requirement that the PPM include all disclosures necessary to make the information contained therein, in context, not misleading
- Limited periodic reporting requirements
- Limited recordkeeping requirements
- Notice requirements
Advisory 18-96

- Available for non-U.S. funds with no U.S. person investors
- CPO must be registered
- No meetings or administrative proceedings in the United States
- More complete disclosure document and recordkeeping relief
- Requires that exemption notice be filed with the CFTC and the NFA in paper form
Expanding Your Compliance Procedures
Supervisory Procedures for APs

- Procedures should cover:
  - Hiring policies
  - Registration
  - Customer information
  - Account activity
  - Discretionary accounts
  - Promotional material
  - Customer complaints
  - Ongoing training

- Should consider listening to sales pitches and reviewing trading in customer and employee accounts
NFA By-Law 1101

- “Self-policing” mechanism that requires that registered CPOs and CTAs only transact business with persons who are:
  - NFA Members (FCMs, introducing brokers ("IBs"), CPOs, CTAs, swap dealers, major swap participants) or
  - Exempt from registration or not required to be registered

- Impacts fund managers primarily in four ways:
  - Affects their due diligence process with underlying managers (if a fund of funds)
  - Affects their due diligence process with their own investors/clients
  - Affects their FCM and IB relationships
  - Affects their use of solicitors
NFA By-Law 1101 – Due Diligence on Underlying Managers

- Is the manager trading commodity interests? If yes, then:
  - Identify the CPO(s) and the CTA(s)
  - Determine whether the CPO(s) and CTA(s) are registered or exempt from registration
  - If exempt, on what basis
  - Check the NFA website (www.nfa.futures.org) to confirm that appropriate filings have been made
  - Get a representation

- It is theoretically possible that some underlying managers may also be “major swap participants,” which is a new registration category post-Dodd-Frank
NFA By-Law 1101 – Due Diligence on Investors/ Clients

- Are they themselves pools? (Reliance on CFTC Regulation 4.13(a)(3), operator registered as a CPO?)
- Are they plans? (Some plans must file CFTC Regulation 4.5 notices and some do not)
- Are they foundations and endowments?
- Are they natural persons?
- Are they separate accounts of a U.S. insurance company?
- Are they bank or trust accounts with a bank trustee with investment authority?
- Are they Non-United States persons?
- Need to evaluate existing investors
NFA By-Law 1101 – Due Diligence on Counterparties

- Are they FCMs or IBs?
- Are they swap dealers?
- Are they major swap participants?
NFA By-Law 1101 – Due Diligence on Solicitors

- Are they broker-dealers?
- Are they just registered investment advisers (but not CTAs)?
- Do they only solicit Non-United States persons?
Promotional Materials and Solicitation

- Need written marketing materials review procedures
- Appropriate supervisory personnel must approve, in writing, each piece of promotional material
- Review should be performed by someone other than the person who prepared the piece
- Maintain records of each piece and its approval
Promotional Materials and Solicitation (cont’d)

- CFTC and NFA have specific guidance regarding:
  - Testimonials (CFTC Regulation 4.41)
  - Hypothetical or simulated performance (NFA Compliance Rule 2-29) (Does not apply to CFTC Regulation 4.7 pools/accounts)
  - If mention possibility of profit, must mention risk of loss
  - If mention performance, must say past performance is not necessarily indicative of future results
  - Performance must be calculated consistent with CFTC guidance (but can continue to show gross of manager fees performance in one-on-one presentations generally consistent with SEC guidance)
Bunching/Allocation of Trades

- CFTC Regulation 1.35(a-1)(5) permits CTAs to submit bunched orders (without identifying specific discretionary clients)

- Orders may be allocated post-execution if:
  - Allocation is made as soon as practicable after execution and no later than sufficiently before end of trading day to permit clearing records to identify the ultimate customers
  - Fair and equitable allocation
  - Sufficiently objective and specific to permit independent verification by the CFTC, the NFA and outside auditors
Bunching/Allocation of Trades (cont’d)

- No affirmative disclosures required but should disclose, including whether proprietary accounts are included
  - Must disclose if asked
  - Must provide composite or summary data to allow client to compare results of executions
  - Best practice is to disclose in PPM and/or Form ADV
- CPO may also rely on this guidance if it also executes trades
Customer Complaints

- Procedures should cover:
  - Name of individual responsible for handling customer complaints
  - Types of records to be maintained in customer complaint file
  - Process to be followed by responsible individual for determining whether disciplinary action is required

- Keep a log including names of customer and personnel involved, timeframe, description of complaint and description of resolution

- If complaint is settled, keep settlement agreement in file
CPO/CTA Self-Examination Checklist

- Must complete annually general section and supplemental section relating to registration category (CPO, CTA, FCM or IB)
- Must be signed and dated by appropriate supervisory personnel
- Separate attestation for each branch office
- SEC annual review is not sufficient
Annual Questionnaire

- Completed on line
- Must be done at least annually by anniversary of your NFA membership date
- Can be updated as business changes
Ethics Training

- CPO/CTA can determine frequency, duration and provider
- Still need a policy
- Need to keep records of program, date, name of provider and personnel who attended
NFA Quarterly Reporting

- Quarterly reporting to NFA by registered CPOs of:
  - Name of pool’s administrator, carrying broker(s), trading manager(s) and custodian(s)
  - Statement of changes in NAV for quarter
  - Monthly performance for the quarter
  - Schedule of investments listing each >10% investment at the end of the quarter
Larger Trader Reporting/Position Limits

- Form 40 (for futures and options)
- There are position limits for futures and options on certain agricultural commodities
- Trading by certain persons is aggregated
Anti-Money Laundering

- CPOs/CTAs are not currently required to adopt know your customer procedures
- Must comply with Office of Foreign Assets Control directives, including checking Specially Designated Nationals and Blocked Persons list
Business Continuity Plans

- NFA will expect CPO/CTA to have one and to test it periodically
- Should not generally need to have something different than what is acceptable to the SEC
- Under NFA Compliance Rule 2-38(b), must provide NFA with name and contact information for an individual whom NFA can contact in an emergency, and a back-up individual (in annual questionnaire)
- These persons must be authorized to make key decisions in an emergency
Form 7-R Updating

- Must be done annually
- Amend promptly to correct deficiencies or inaccuracies
Forms CPO-PQR and CTA-PR
Forms CPO-PQR and CTA-PR

- CFTC adopted CFTC Regulation 4.27(d) that, jointly with the SEC, establishes new reporting requirements with respect to private funds:
  - Requires CPOs and CTAs to report certain information to the CFTC on Forms CPO-PQR and CTA-PR, respectively
  - CPOs dually registered with the SEC and CFTC that file Sections 1 and 2 of Form PF, as applicable, must generally file Schedule A of Form CPO-PQR only
  - Non-dually registered CPOs must file all relevant sections of Form CPO-PQR based on certain reporting thresholds
  - All CTAs, regardless of SEC registration, will complete Form CTA-PR
  - Both forms must be filed via NFA’s EasyFile System
  - Only file for funds where you are acting as a registered CPO (no need to report CFTC Regulation 4.13(a)(3) funds)
## CPO-PQR Schedules, Thresholds, and Deadlines

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<th>Assets Under Management</th>
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<th>Schedule B</th>
<th>Schedule C</th>
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<tr>
<td>Dually registered (at least $1.5 billion AUM)</td>
<td>Quarterly – 60 days (also filing Form PF)</td>
<td></td>
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<tr>
<td>Dually registered (less than $1.5 billion AUM)</td>
<td>Annually – 90 days (also filing Form PF)</td>
<td></td>
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<tr>
<td>Large CPO (at least $1.5 billion AUM)</td>
<td>Quarterly – 60 days (not filing Form PF)</td>
<td>Quarterly – 60 days (for each pool)</td>
<td>Quarterly – 60 days (for each “Large Pool”)</td>
</tr>
<tr>
<td>Mid-Sized CPO (at least $150 million AUM)</td>
<td>Annually – 90 days (not filing Form PF)</td>
<td>Annually – 90 days (for each pool)</td>
<td></td>
</tr>
<tr>
<td>Small CPO (less than $150 million AUM)</td>
<td>Annually – 90 days (not filing Form PF)</td>
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## CPO-PQR Initial Filing Deadlines (31/12 fiscal year)

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<th>Commodity Pool Assets Under Management</th>
<th>Deadline</th>
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<td>Large CPOs with at least $5 billion AUM in commodity pools</td>
<td>29 November 2012*</td>
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<tr>
<td>Large CPOs with between $1.5 billion and $5 billion AUM in commodity pools</td>
<td>1 March 2013</td>
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<tr>
<td>All other CPOs</td>
<td>31 March 2013</td>
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*If registered in 2012.
Form CTA-PR

- Only Schedule A of Form CTA-PR was adopted
- Schedule A requires all CTAs to provide basic information about the CTA’s business and the pools for which it provides advice
- Form CTA-PR needs to be filed on an annual basis within 45 days after the end of the CTA’s fiscal year
- Initial filing due on 14 February 2013 for most CTAs
Exemptions from CTA Compliance Obligations Without Registration
CTA Exemptions

- Under CFTC Regulation 4.14(a)(8), certain persons may be exempt from registration as CTAs and from complying with the CFTC’s CTA disclosure and recordkeeping requirements.

- Such persons include persons who are:
  - Registered as investment advisers under the Investment Advisers Act of 1940 (“Advisers Act”)
  - Excluded from the definition of “investment adviser” pursuant to Sections 202(a)(2) (certain banks and trust companies) or 202(a)(11) of the Advisers Act
  - U.S. state-registered investment advisers or
  - Investment advisers that are exempt from federal and state registration.
CTA Exemptions (cont’d)

- However, to qualify for this exemption, the investment adviser must comply with the following requirements:
  - Advice must be furnished only to certain entities excluded from the commodity pool definition:
    - “Qualified entities” and entities excluded from the commodity pool definition under CFTC Regulation 4.5 (i.e., non-contributory, governmental and church plans),
    - Pools that are organized and operated outside of the United States and have only non-U.S. person investors, and
    - CFTC Regulation 4.13(a)(3) pools (no longer CFTC Regulation 4.13(a)(4) pools)
  - Advice must be “solely incidental” to investment adviser’s business
  - The investment adviser must not otherwise hold itself out as a CTA
  - CFTC Regulation 4.14(a)(8) also contains certain annual notice filing requirements and requires the retention of certain records, and persons who rely upon the exemption are subject to special calls by CFTC staff
CTA Exemptions (cont’d)

- Under CEA Section 4m(3), a person who is registered as an investment adviser under the Advisers Act whose business does not consist primarily of acting as a CTA, and who does not act as a CTA to any investment trust, syndicate, or similar form of enterprise that is engaged primarily in trading in any commodity interest, is exempt from registration as a CTA.

- If a CTA holds itself out to the public as being primarily engaged in advising on commodity interests or investing, reinvesting, owning, holding or trading them, it cannot rely on this exemption.
CTA Exemptions (cont’d)

- Section 4m(1) of the CEA exempts from registration a CTA who provides commodity interest trading advice to 15 or fewer persons within the preceding 12 months and who does not hold itself out to the public as a CTA
  - CFTC adopted CFTC Regulation 4.14(a)(10) in 2003 to provide that any entity advised by a CTA that receives commodity interest trading advice based on its investment objectives, rather than on the individual investment objectives of its investors, would count as only one “person” for purposes of determining eligibility for the exclusion from registration under Section 4m(1) of the CEA
- This exemption, if applicable, also exempts the CTA from the CFTC’s CTA disclosure and recordkeeping requirements
- However, if a CTA holds itself out to the public as a CTA, this exemption does not apply, regardless of how many persons the CTA advises
- Can combine CFTC Regulation 4.14(a)(8) with either CEA Sections 4m(1) or 4m(3) – Interpretive Letter 05-13
Exemption from CTA Compliance Obligations for Registered CTAs
Exemption for Persons Who Provide Advice to QEPs

- CFTC Regulation 4.7(c) provides an exemption from almost all the disclosure and recordkeeping requirements otherwise applicable to registered CTAs.
- However, this exemption is available only to registered CTAs and only with respect to commodity interest trading advice provided to persons that the CTA “reasonably believes” are QEPs as defined in CFTC Regulation 4.7(a)(2-3).
- This exemption has its own limited disclosure requirements, recordkeeping requirements and notice requirements.
Ms. Gault-Brown is a partner in K&L Gates’ Washington, D.C. office and a member of the Investment Management practice. She advises participants in the financial services industry, including commodity trading advisors, commodity pool operators, investment advisers, private funds, and registered investment companies on regulatory, transactional and counseling matters involving the securities and commodities laws. Ms. Gault-Brown regularly works with commodity trading advisors and commodity pool operators with respect to registration, disclosure, and compliance issues. Ms. Gault-Brown also regularly counsels registered investment companies about issues raised by investments in derivatives under the Investment Company Act. Ms. Gault-Brown joined the firm after three years at the SEC where she was a senior counsel in the Division of Investment Management’s Office of Chief Counsel. At the SEC, among other matters, Ms. Gault-Brown focused on the regulatory treatment under the federal securities laws and commodities laws of registered funds and registered advisers that used OTC derivatives.

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Mr. Patent is of counsel in K&L Gates’ Washington, D.C. office and a member of the Investment Management practice. He regularly counsels businesses with respect to commodity interest trading compliance and the legal requirements governing trading in over-the-counter derivatives and exchange-traded futures, including both international and U.S. markets. His clients include, among others, hedge funds, currency dealers, commodity pool operators, commodity trading advisors, futures commission merchants, and introducing brokers. He services diverse client needs, including advice regarding the registration, disclosure, and other regulatory requirements of the CFTC and the NFA, preparation of internal compliance procedures and policies for trading operations, time-sensitive legal advice concerning particular market positions and strategies, and compliance training. Mr. Patent has been very active in all phases of the Dodd-Frank financial regulatory reform process, including both the legislative and implementation aspects.