



CFTC Provides Streamlined No-Action Relief Filing Procedure

Posted by Yaron Nili, Co-editor, HLS Forum on Corporate Governance and Financial Regulation, on Saturday June 21, 2014

Editor's Note: The following post comes to us from [Carolyn A. Jayne](#), partner in the Investment Management, Hedge Funds and Alternative Investments practice at K&L Gates LLP, and is based on a K&L Gates publication by Ms. Jayne, [Cary J. Meer](#), and [Lawrence B. Patent](#); the complete publication, including footnotes, is available [here](#).

The Division of Swap Dealer and Intermediary Oversight (the "Division") of the Commodity Futures Trading Commission ("CFTC" or the "Commission") recently issued CFTC Letter No. 14-69 (May 12, 2014) (the "Letter"), which provides to certain commodity pool operators ("CPOs") who delegate (the "Delegating CPO") their CPO responsibilities to registered CPOs (the "Designated CPO") a standardized, streamlined approach to apply for no-action relief from the requirement to register as a CPO. The Division previously has granted no-action relief to many Delegating CPOs on an individualized basis. However, the Division recently has seen a substantial increase in the number of no-action requests after the rescission of the CPO exemption from registration in Regulation 4.13(a)(4) and the adoption of a broad definition of the types of swaps subject to CFTC regulation. This streamlined approach will eliminate the need for many, **but not all**, Delegating CPOs to apply for individualized no-action relief, a more labor-intensive and time-consuming endeavor. However, this approach is available only under certain circumstances described below, and not all Delegating CPOs will qualify.

The Conditions

The following conditions ("Criteria") must be satisfied to request CPO registration no-action relief through this streamlined approach:

- 1.
 - a. Pursuant to a legally binding document, the Delegating CPO must delegate to the Designated CPO all of its investment management authority with respect to the commodity pool;

- b. The Delegating CPO cannot participate in the *solicitation* of participants for the commodity pool; and
 - c. The Delegating CPO cannot *manage any property* of the commodity pool.
- 2. The Designated CPO must be registered as a CPO.
- 3. The Delegating CPO must not be subject to a *statutory disqualification* under Section 8a(2) or 8a(3) of the Commodity Exchange Act (the “CEA”).
- 4. There must be a *business purpose* for the Designated CPO being a separate entity from the Delegating CPO that is not solely to avoid registration by the Delegating CPO under the CEA and the Commission’s regulations.
- 5. The books and records of the Delegating CPO with respect to the commodity pool must be maintained by the Designated CPO *in accordance with Regulation 1.31*, the regulation setting forth general requirements for all books and records required to be kept under the CEA and regulations thereunder.
- 6. If the Delegating CPO and the Designated CPO are each a non-natural person, then one such CPO must control, be controlled by, or be under common control with the other CPO.
- 7. If a Delegating CPO is a non-natural person, then such Delegating CPO and the Designated CPO must have executed a legally binding document whereby each undertakes to be *jointly and severally liable* for any violation of the CEA or the Commission’s regulations by the other in connection with the operation of the commodity pool.
- 8. If a Delegating CPO is a natural person and is *not* an Unaffiliated Board Member, as defined below, then such Delegating CPO and the Designated CPO must have executed a legally binding document whereby each undertakes to be *jointly and severally liable* for any violation of the CEA or the Commission’s regulations by the other in connection with the operation of the commodity pool.
- 9. If a Delegating CPO is an Unaffiliated Board Member, then such Delegating CPO must be subject to liability as a Board member in accordance with the laws under which the commodity pool is established.

Analysis and Limitations of this Relief

The Division intended this relief to apply to certain fact patterns that it encounters regularly in no-action requests. For example, one condition to qualify to use this approach is that, if the Delegating CPO and Designated CPO are each non-natural persons, then one such CPO controls, is controlled by, or is under common control with the other CPO. Many pools utilize separate but affiliated investment advisers and general partners or managing members and will

meet this condition. The Division also requires that these affiliated entities enter into a legally binding document whereby each undertakes to be jointly and severally liable for any violation of the CEA or the CFTC's regulations thereunder by the other in connection with the operation of such pool, which should be a fairly noncontroversial requirement for affiliated entities.

The Division likewise intended this relief to apply to a natural person Delegating CPO who is an "Unaffiliated Board Member," which the Division defined in the Letter as a natural person who is a voting member of the board of directors or an equivalent governing body of the commodity pool who: (i) is not a member of the management or an employee of the Designated CPO or any affiliate thereof; (ii) is not a substantial beneficial owner of the Designated CPO or any affiliate thereof or of any company holding more than 5% of such Designated CPO's beneficial ownership interests or any affiliate thereof; and (iii) has no other interest or relationship that could interfere with his/her ability to act independently of management of the Designated CPO or any affiliate thereof or of any company holding more than 5% of such Designated CPO's beneficial ownership interests or any affiliate thereof. For Delegating CPOs who are Unaffiliated Board Members, the Division does not require the Delegating CPO to be jointly and severally liable with the Designated CPO, although the Delegating CPO will remain subject to liability as a board member in accordance with the laws under which the pool is established. Given that certain facts relevant to the independence analysis may not be readily determined, Delegating CPOs would be well advised to request a certificate from the director confirming his or her independence.

Notably, natural person Delegating CPOs who are affiliated with the Designated CPO must comply with certain restrictions on their activities in order to rely on the Letter. As a condition to utilizing the streamlined approach, the Delegating CPO cannot participate in the investment management or solicitation of participants for the pool, nor can the Delegating CPO manage any property of the commodity pool, even if the Delegating CPO is engaging in these activities as an associated person or employee of the Designated CPO. Many pools appoint one or more affiliated persons to the board of directors of a pool domiciled outside of the United States. Often these affiliated board members also serve as associated persons of the registered CPO of the pool, which disqualifies them from utilizing the streamlined approach. The Division acknowledged that "the Commission's view that the investment adviser of a registered investment company is the entity that should register as the CPO for the company, not the members of the company's board." However, the Division's view in the Letter appears to be that affiliated board members *would* be characterized as additional CPOs to pools with existing registered CPOs, while their fellow non-affiliated board members qualify for the streamlined approach to no-action relief. These affiliated board members could apply for individualized no-action relief, but such relief, if granted, might take several months to obtain. Otherwise, the board should be reconstituted with only members who qualify for the streamlined no-action relief. This might require replacing certain

affiliated board members with persons associated with the investment manager who are not involved with solicitation or portfolio management. We understand that the Division is considering expanding the eligibility for streamlined no-action relief in the Letter to cover affiliated board members who are involved in solicitation and/or investment management activities, subject to conditions, but it unclear whether and when the eligibility for the no-action relief would be expanded.

Claiming No-Action Relief

To request relief using this streamlined approach, the Delegating CPO must submit a no-action request in the form of the Attachment to Letter 14-69 containing the following information:

- 1. The name, main business address, main business telephone number and name of a contact person of each of the Delegating CPO(s) and the Designated CPO;
- 2. The NFA ID Number of the Designated CPO;
- 3. The name(s) of the commodity pool(s) with respect to which relief is being sought;
- 4. A representation that the applicable Criteria are met; and
- 5. A statement from the Designated CPO acknowledging that it has been designated as the registered CPO of the commodity pool(s) and that it satisfies the applicable Criteria.

The Division stated in the Letter that it intends to issue responses to each request for no-action relief, and, in fact, the first no-action letter was issued two days after the request letter.

Conclusion

Although this streamlined approach to request no-action relief from the requirement to register as a CPO will benefit certain Delegating CPOs, not all Delegating CPOs will qualify. Reliance upon the Letter requires that the Delegating CPO and Designated CPO each meet all of the applicable Criteria. In particular, affiliated board members who engage in solicitation or portfolio management activities for a pool will not qualify to utilize the streamlined process to seek no-action relief. Boards may be reconstituted as a result of this Letter to ensure that none of the board members solicits or otherwise manages property of the pool. In any event, non-qualifying Delegating CPOs instead will be able to seek individualized no-action relief from the registration requirement, although there is no assurance that such individualized relief will be granted.