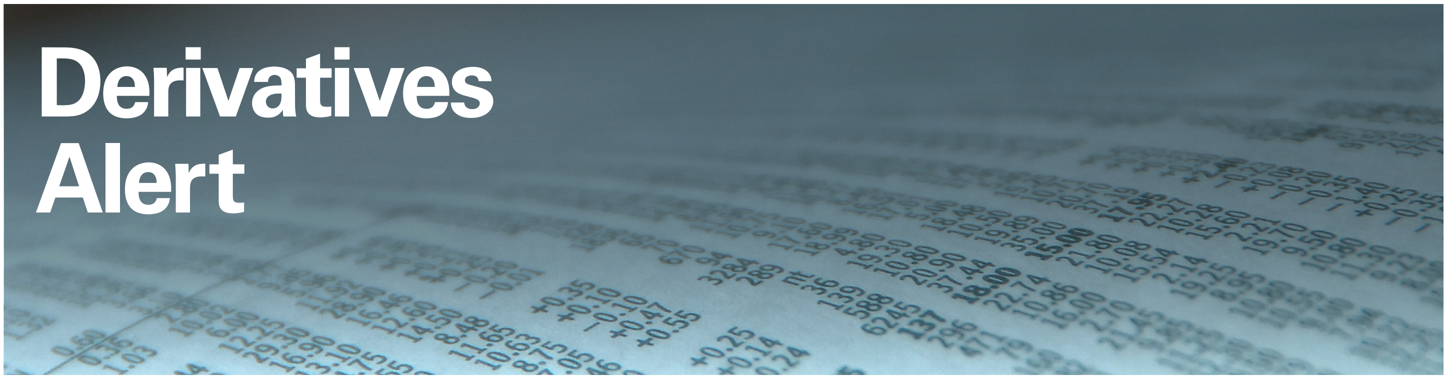

Derivatives Alert

If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

Four Times Square
New York, NY 10036
212.735.3000

CFTC Proposes to Simplify, Modernize Commodity Pool Operator and Commodity Trading Advisor Regulations

On October 18, 2018, the Commodity Futures Trading Commission (CFTC) published a proposal in the Federal Register (Proposed Rule)[1] to amend several key compliance and registration regulations governing commodity pool operators (CPOs) and commodity trading advisors (CTAs). The overarching goal of the CFTC's proposal is to simplify and modernize those regulations by codifying (and, in certain respects, expanding upon) relief in long-standing CFTC staff advisories and no-action letters.[2]

Registration Exemption for CPOs Operating in Multiple Jurisdictions

The CFTC proposes to amend CFTC Regulation 4.13 (which provides exemptions from CPO registration) so that a CPO would not have to register as a CPO with respect to any of its offshore pools for which the CPO solicits and/or accepts funds only from persons located outside the U.S. This registration exemption would be available on a pool-by-pool basis, meaning that the CPO could claim the exemption with respect to its offshore pools meeting the specified criteria for the new exemption while maintaining CPO registration with respect to other pools (*e.g.*, offshore pools with U.S. participants).[3]

The proposed registration exemption is based on CFTC Staff Advisory 18-96, but the relief would be more extensive than Advisory 18-96, which does not offer an exemption from CPO registration but rather merely relief from certain compliance obligations. Further, the CFTC explained that the proposed registration exemption would be more flexible than the CPO registration exemption in CFTC Regulation 3.10(c)(3) because, whereas the proposed registration exemption can be claimed on a pool-by-pool basis, the 3.10(c)(3) exemption is available only to offshore CPOs that limit their CPO activities solely to offshore pools with offshore participants. According to the CFTC, in "providing CPO registration relief beyond that currently provided by [CFTC Regulation] 3.10(c)(3)(i) and by staff relief in Advisory 18-96," the new registration exemption "would be beneficial and consistent with the [CFTC's] past prioritization of agency resources for the regulation of intermediary activities affecting U.S. participants."[4]

[1] *See* "Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors," 83 Fed. Reg. 52,902 (Oct. 18, 2018).

[2] Proposed Rule at 52,903-4.

[3] *Id.* at 52,914, 52,926-7.

[4] *Id.* at 52,921.

The existing timing and claims process for other CPO exemptions would apply to the proposed exemption, and all existing claimants under Advisory 18-96 could claim the proposed exemption.[5]

Relief From Record Location Requirement for Certain CPOs With Offshore Pools

The CFTC proposes to codify certain relief provided in Advisory 18-96 that would allow qualifying, registered onshore CPOs to maintain their offshore pool's original books and records at the pool's offshore location, rather than at the CPO's main business office in the U.S. To qualify for this relief, a CPO would need to meet conditions that are based on the criteria for recordkeeping location relief set forth in Advisory 18-96.[6]

Prohibition on Claiming Certain CPO Registration Exemptions if Subject to Statutory Disqualification

The CFTC proposes to require any person claiming certain CPO registration exemptions under CFTC Regulation 4.13 to represent that neither the claimant nor any of its principals is subject to statutory disqualifications under Sections 8a(2) or 8a(3) of the Commodity Exchange Act.[7] This proposed requirement is meant to address the CFTC's concern that the current Part 4 regulations may present an "undue risk from a customer protection standpoint" by allowing a person that is statutorily disqualified from registering as a CPO to nonetheless claim a CPO registration exemption. Under the CFTC's proposal, statutory disqualifications would not preclude claiming a CPO registration exemption where the disqualifications (1) were previously disclosed in a registration application that was granted, or (2) were disclosed more than 30 days prior to the claim of the CPO registration exemption.[8]

Inclusion of Non-US Persons as Type of Eligible Commodity Pool Participant in De Minimis Commodity Pools Under CFTC Regulation 4.13(a)(3)

The CFTC proposes to amend the CPO registration exemption under CFTC Regulation 4.13(a)(3) (often referred to as the de minimis exemption) to explicitly allow for non-U.S. persons, regardless of their financial sophistication, to be participants in the pools for which the de minimis exemption is claimed. This proposal would essentially codify the approach in CFTC Staff Letter 04-13, where CFTC staff confirmed that a CPO need not consider whether non-U.S. person participants meet the investor sophistication criteria of Rule 4.13(a)(3) in determining whether the CPO qualifies for the de minimis exemption.

CPO and CTA Registration Exemptions for Qualifying Family Offices

The CFTC proposes to adopt CPO and CTA registration exemptions that, in effect, codify two CFTC staff no-action letters relating to family offices. The proposed CPO registration exemption would be equivalent to the relief in CFTC Staff Letter 12-37,[9] which permits "family offices" (as that term is defined in regulations promulgated by the Securities and Exchange Commission (SEC))[10] to operate and manage assets of "family clients" (as that term is defined in SEC regulations)[11] without having to register with the CFTC as a CPO.[12] The proposed CTA registration exemption would be consistent with CFTC Staff Letter 14-143,[13] which permits family offices to provide their family clients with commodity trading advice, without CTA registration, provided that the family office does not hold itself out to the public as a CTA

[5] *Id.* at 52,914.

[6] *Id.* at 52,906 and 52,927-8.

[7] This proposed requirement would not apply to claiming the proposed CPO registration exemption for family offices, which is discussed *infra.*

[8] *Id.* at 52,906 and 52,914.

[9] *See* CFTC No-Action Letter 12-37.

[10] SEC regulations define "family office" as a company (including its directors, partners, members, managers, trustees and employees acting within the scope of their position or employment) that: (1) has no clients other than family clients; (2) is wholly owned by family clients and is exclusively controlled (directly or indirectly) by one or more family members and/or family entities; and (3) does not hold itself out to the public as an investment adviser. 17 C.F.R. 275.202(a)(11)(G)–1(b).

[11] SEC regulations define "family client" to mean (1) any family member; (2) any former family member; (3) any key employee; (4) certain former key employees; (5) any nonprofit organization, charitable foundation or charitable trust (including charitable lead trusts and charitable remainder trusts whose only current beneficiaries are other family clients and charitable or nonprofit organizations); (6) any estate of a family member, former family member or key employee, or certain former key employees that are covered in (4); (7) any irrevocable trust in which one or more other family clients are the only current beneficiaries; (8) any irrevocable trust funded exclusively by one or more other family clients in which other family clients and nonprofit organizations, charitable foundations, charitable trusts or other charitable organizations are the only current beneficiaries; (9) any revocable trust of which one or more other family clients are the sole grantor; (10) any trust of which: each trustee or other person authorized to make decisions with respect to the trust is a key employee; and each settlor or other person who has contributed assets to the trust is a key employee or the key employee's current and/or former spouse or spousal equivalent who, at the time of contribution, holds a joint, community property or other similar shared ownership interest with the key employee; or (11) any company wholly owned (directly or indirectly) exclusively by, and operated for the sole benefit of, one or more other family clients; provided that if any such entity is a pooled investment vehicle, it is excepted from the definition of "investment company" under the Investment Company Act of 1940. 17 C.F.R. 275.202(a)(11)(G)-1(d)(4).

[12] Proposed Rule at 52,908-9.

[13] *See* CFTC No-Action Letter 14-143.

and restricts any commodity trading advice to the family office itself and/or family clients.[14] Whereas the proposed CPO registration exemption would need to be claimed through an electronic notice filing, the proposed CTA registration exemption would be self-executing, *i.e.*, not require a notice filing.[15]

Amendments Permitting General Solicitation by CPOs Pursuant to the JOBS Act

The CFTC is proposing targeted amendments to CFTC Regulations 4.7 and 4.13(a)(3) to ensure consistency with SEC regulations that have been implemented pursuant to the JOBS Act.[16] In particular, the SEC adopted exemptions from securities registration requirements that allow for certain issuers and resellers of securities to engage in general marketing and solicitation.[17] CFTC regulations come into play where such issuers and resellers of securities are also issuing shares in a commodity pool. Certain CFTC regulations prevent a CPO from claiming registration and/or regulatory compliance relief where the CPO is engaging in general marketing and solicitation. The CFTC is now seeking to harmonize its rules with those adopted by the SEC by eliminating the general marketing restriction in CFTC Regulations 4.7 and 4.13(a)(3) to the extent that the CPO claiming relief under those regulations is otherwise complying with the securities law exemptions. The CFTC's proposed amendments in this regard would codify CFTC Staff Letter 14-116's relief from the general marketing restriction in CFTC Regulations 4.7 and 4.13(a)(3).[18]

Exclusionary Relief for Business Development Companies

The CFTC proposes to amend Regulation 4.5 (which excludes certain otherwise regulated persons from the CPO definition) to exclude investment advisers of business development companies (BDCs) from the CPO definition. If adopted, this proposed amendment would effectively supersede no-action relief under CFTC Staff Letter 12-40, which provides CPO registration relief to the operators of BDCs provided that certain conditions are met. The CFTC explained that the reasons for proposing to exclude BDCs from the CPO definition are the same reasons that prompted CFTC staff to grant no-action relief for BDCs in Letter 12-40 — namely, BDCs are subject to oversight by the SEC that is comparable to the regulation of registered investment companies, and BDC's use of commodity interests is primarily for bona fide hedging purposes.[19]

Relief From Filing Forms CPO-PQR and CTA-PR

The CFTC proposes to amend CFTC Regulation 4.27's definition of a "reporting person," which defines who is required to file a Form CPO-PQR for CPOs or a Form CTA-PR for CTAs. Currently, the "reporting person" definition includes CPOs and CTAs that are registered or required to be registered and therefore captures CPOs and CTAs that have elected to maintain an active registration with the CFTC even though they operate exempt pools or do not direct any client accounts. The CFTC's proposed amendments would exclude from the "reporting person" definition CPOs that operate only pools for which they are otherwise excluded from the CPO definition or exempt from CPO registration, and CTAs that do not direct client accounts. These proposed amendments would be consistent with exemptive relief currently provided in CFTC Staff Letters 14-115 and 15-47. In addition, the CFTC proposes to exclude from the "reporting person" definition registered CTAs that only advise pools for which the CTA is also the CPO (whether registered as a CPO or exempt from CPO registration).[20]

Request for Comments

The CFTC raises specific questions for commenters on the proposed exemption to replace Advisory 18-96, the proposed family office exemptions, the proposal to amend Regulations 4.7 and 4.13(a)(3) to permit general solicitation in accordance with the JOBS Act, and the proposal to revise the "reporting person" definition relevant to CPO-PQR and CTA-PR filings.[21] Comments on the proposal must be received on or before December 17, 2018.

[14] Proposed Rule at 52,909.

[15] *Id.* at 52,915.

[16] *Id.* at 52,915-16.

[17] Proposed Rule at 52,909-10.

[18] *Id.* at 52,911; *see also* CFTC No-Action Letter 14–116.

[19] Proposed Rule at 52,916.

[20] *Id.* at 52,916

[21] *Id.* at 52,917.

Contacts

Michael K. Hoffman
Partner / New York
212.735.3406
michael.hoffman@skadden.com

Maureen A. Donley
Of Counsel / Washington, D.C.
202.371.7570
maureen.donley@skadden.com

Jonathan Marcus
Of Counsel / Washington, D.C.
202.371.7596
jonathan.marcus@skadden.com

Kenneth E. Burdon
Counsel / Boston
617.573.4836
kenneth.burdon@skadden.com

Prashina J. Gagoomal
Associate / New York
212.735.3392
prashina.gagoomal@skadden.com

Shekida A. Smith
Associate / Washington, D.C.
202.371.7382
shekida.smith@skadden.com