# U.S. Commodity Exchange Act and Related Regulatory Issues

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# Introduction

- Sponsors and Managers of a "commodity pool" must register with the Commodity Futures Trading Commission ("CFTC") and the National Futures Association ("NFA") as a Commodity Pool Operator, or "CPO." Anyone who advises and/or manages the trading of a "commodity pool" must register with the CFTC and the NFA as a Commodity Trading Advisor, or "CTA."
- Although any "private investment fund" [an investment fund exempt from the registration requirements of the Investment Company Act by virtue of Sections 3(c)(1) or 3(c)(7)] may be a commodity pool, a registered investment company (pursuant to the Investment Company Act) is exempt from CPO registration even if the registered fund invests and/or trades in commodity interests regulated by the CFTC and the NFA [CFTC Regulations § 4.5].
- There are, in addition, a series of complete exemptions from CPO and CTA registration as well as other exemptions available to a registered CPO or CTA that manages or advises only exempt pools.

# “Commodity Pool” and Exemptions

- The term “commodity pool” is defined broadly under the Commodity Exchange Act (“CEA”) to include “any investment trust, syndicate or similar form of enterprise operated for the purpose of trading in commodity interests, including any – commodity for future delivery, securities futures product or swap, agreement in foreign currency interests for future or forward delivery (other than to certain institutional and/or trade counterparties), commodity option and certain defined “leveraged transactions.” [CEA § 1a (10).]

- Generally, a “commodity pool operator” is broadly defined to include any person engaged in the business of sponsoring, managing, soliciting investments in and/or operating a commodity pool. [CEA § 1a (11).]

# "Commodity Pool" and Exemptions

- The CFTC is authorized to make additional definitions and to exclude certain entities and transactions from the relevant definitions. The CFTC has, by regulation, excluded certain otherwise regulated persons from the definition of the term "commodity pool operator" and from the term "commodity trading advisor."

# “Commodity Pool” and Exemptions

- Persons exempt from the definition of commodity pool operator include
  a. Registered Investment Companies,
  b. Insurance Companies subject to regulation by any State,
  c. Banks, trust companies and other depository institutions subject to regulation by any state or by the US, and
  d. Trustees and other named fiduciaries of certain pension, retirement or benefit plans pursuant to the Employee Retirement Income Security Act of 1974 (“ERISA”) – although there are certain additional categories of ERISA-related plans that are not deemed to be “pools.”

# “Commodity Pool” and Exemptions

- To claim this exemption (found in CFTC Regulation 4.5, the person must file a Notice of Exemption, which includes a representation that participants in the relevant pool will be notified of this exemption and its applicability to the relevant pool.  In addition, if the pool is a registered investment company, the Notice must also represent that the commodity interests are employed solely for bona fide hedging purposes and that margin requirements for the commodity interests do not and will not exceed more than five percent of the (notional) value of the pool’s portfolio.

# "Commodity Trading Adviser" and Exemptions

- The term "Commodity Trading Adviser" is broadly defined in the CEA  as any person who, for compensation or profit, engages in the business of advising others, either directly or indirectly … as to the value or advisability of trading in any futures contract or any other investment product or vehicle that is subject to the regulatory jurisdiction of the CFTC. [CEA § 1a (12).]

# “Commodity Trading Adviser” and Exemptions

- Under the CEA, “commodity trading adviser” does not include any of the following, but only when the advisory activities of the relevant person or entity are incidental to their business (as described below):
  a. any bank or trust company,
  b. any news reporter, columnist or news editor in the print or electronic media, of any lawyer, accountant or teacher,
  c. any (CFTC-registered) floor broker or futures commission merchant (“FCM”),
  d. the publisher of any print or electronic data of general and regular dissemination,
  e. the fiduciary of any ERISA plan, and
  f. any exchange and/or contract market

# "Commodity Trading Adviser" and Exemptions

- In addition, pursuant to CFTC Regulation § 4.5, the following persons are also exempt from the definition of commodity trading advisor:
  a. Insurance Companies, provided that its commodity interest advisory activities are solely incidental to the conduct of its insurance business,
  b. An exempt person, pursuant to Regulation 4.5 (above) from the definition of a CPO, but only if its commodity interest advisory activities are within the limits provided in Regulation 4.5, and
  c. A swap dealer registered with the CFTC, but only to the extent that the relevant advisory activities are incidental to its business as a "swap dealer."

# "Commodity Trading Adviser" and Exemptions

- Additionally, pursuant to CFTC Regulation § 4.14, persons who are registered with the CFTC and NFA in another capacity (e.g., CPO, FCM, broker or dealer in "cash commodities," associated person of a CPO or FCM, or a person who is exempt from the CPO registration requirements.
- In each above case, the relevant person's commodity-related activities must relate directly to the category of exempt person, above.
- Note that there is no exemption from CTA registration for a person or entity that advises only "exempt" commodity pools. However, as discussed below, CFTC Regulation § 4.7 provides an exemption for registered CTAs who advise only "qualified Eligible Persons."

## Exemption for Registered CPOs and CTAs who deal solely with and to "Qualified Eligible Persons"

- CFTC Regulation § 4.7, provides relief from virtually all of the disclosure document, reporting, documentation and record keeping requirements of the CEA, if a CPO limits the pools that it manages or sponsors to those offered solely to "qualified eligible persons." Regulation 4.7 includes similar relief from virtually all of the disclosure document, reporting, documentation and record keeping requirements of the CEA if a CTA advises only "qualified eligible persons."
- The definition of the term "qualified eligible person" (or "QEP") is complex. Certain categories of QEPs are required to have minimum sized investment portfolios, while others are exempt from the portfolio requirement.

## Exemption for Registered CPOs and CTAs who deal solely with and to "Qualified Eligible Persons"

As relevant to advisers to one or more Commodity Pools, QEPs generally include:

a. The Pool Operator of any exempt commodity pool or any registered CPO who has been registered for more than two years or whose managed pools have greater than $5 million (USD) in contributions as well as any exempt commodity pool itself,

b. Registered Investment Advisers (pursuant to the Investment Advisers Act), provided that they have been registered for more than two years or whose assets under management are greater than $5 million (USD),

## Exemption for Registered CPOs and CTAs who deal solely with and to "Qualified Eligible Persons"

As relevant to advisers to one or more Commodity Pools, QEPs generally include:

c. Any "qualified purchaser" (or "QP") as defined by § 2(a)(51)(A) of the Investment Company Act. (Although the definition of a QP is lengthy and sometimes complex, as relevant to investors in a private fund or pool, the category includes natural persons who, alone or with their spouse, own investment portfolios of not less than $5 million (USD), companies owned by a single "family" that own investment portfolios of not less than $5 million (USD), any trust not formed for the specific purpose of investing in the relevant pool, comprised of any of the above persons and any person who, acting for their own account or for the account of other qualified purchasers who owns or manages investment portfolios of not less than $25 million (USD), and

d. Any knowledgeable employee of the trading advisor.

# Disclosure Document (for non-exempt offerings)

- In the event that a "pool" (private fund) is managed by a registered CPO, all prospective investors in the pool must receive a disclosure brochure that conforms with the requirements of CFTC Regulations. In addition to standard form risk disclosures, there are specific, pervasive requirements respecting the required as well as permissive reporting of prior performance information – both with respect to the same pool as well as with respect to the relevant CPO and/or CTA. CFTC Regulation § 4.25 lists these prohibitions and requirements.
- Should we represent a private fund that is or may be a commodity pool or its sponsors and/or managers, selection of accountants who are experienced with the CFTC Regulations is critical.

# Further information

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