Commodity Futures Trading Commission provides new streamlined process for commodity pool operators to request no-action relief for delegating certain activities to registered CPOs

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Abstract

Purpose – To provide an overview of a new, streamlined process from the Division of Swap Dealer and Intermediary Oversight (DSIO) of the Commodity Futures Trading Commission (CFTC) by which a commodity pool operator (CPO) may request expedited no-action relief for failure to register under Section 4m(1) of the Commodity Exchange Act if such CPO has designated another, registered CPO to serve as the CPO of the commodity pool.

Design/methodology/approach – Explains the background to the CPO registration no-action relief related to CPO delegation and the streamlined process for requesting no-action relief, including the procedure for requesting relief and the applicable criteria that must be satisfied to utilize the streamlined process.

Findings – By providing an alternative, streamlined process for requesting no-action relief from CPO registration in the context of delegation arrangements in certain circumstances, the CFTC staff is attempting to facilitate obtaining such relief, particularly since relief may be sought on behalf of multiple commodity pools by means of a single request. However, the criteria that must be fulfilled in order to utilize the streamlined process are not necessarily applicable to all CPOs and in all scenarios. Thus, certain CPOs may need to request no-action relief outside of the new, streamlined process or consider alternative fund structures.

Originality/value – Practical guidance from experienced asset management lawyers.

Keywords USA, Commodity Futures Trading Commission (CFTC), Commodity Pool Operator (CPO), Derivatives, Division of Swap Dealer and Intermediary Oversight (DSIO)

Paper type Technical paper

Introduction

On May 12, 2014, the Division of Swap Dealer and Intermediary Oversight (“DSIO”) of the Commodity Futures Trading Commission (the “Commission” or “CFTC”) unveiled a new, streamlined process in Staff Letter No. 14-69 by which a commodity pool operator (“CPO”) may request expedited no-action relief for failure to register under Section 4m(1) of the Commodity Exchange Act (the “Act” or “CEA”) if such CPO has designated another, registered CPO to serve as the CPO of the commodity pool[1]. To be eligible to request no-action relief under this new process, the delegating CPO and the designated CPO must fulfill certain criteria outlined by DSIO in the letter. However, DSIO acknowledged that certain circumstances may warrant no-action relief but might not conform to the criteria for this new process – accordingly, DSIO will also continue to review requests for CPO registration no-action relief from persons who are unable to satisfy the criteria outlined below. DSIO further noted that it may expand the streamlined process to address additional scenarios in the future.
Background

Section 1a(11)(A)(i) of the CEA defines the term “commodity pool operator” to mean any person:

i. engaged in a business that is of the nature of a commodity pool, investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in commodity interests, including any:

I. commodity for future delivery, security futures product, or swap;

II. agreement, contract, or transaction described in section 2(c)(2)(C)(i) of this title or section 2(c)(2)(D)(i) of this title;

III. commodity option authorized under section 6c of this title; or

IV. leverage transaction authorized under section 23 of this title[2]

Under Section 4m(1) of the CEA, it is unlawful for any person who is a CPO to “make use of the mails or any means or instrumentality of interstate commerce in connection with [. . .] [CPO]” unless such person is registered under the CEA as a CPO[3].

For a number of years, the CFTC staff has been reviewing requests from, and often granting no-action relief to, CPOs under circumstances where

- such CPOs (“Delegating CPOs”) have delegated investment management authority of a commodity pool to another person that is registered as a CPO (“Designated CPO”); and

- the Delegating CPO does not engage in the solicitation of participants for, or the management of property of, the applicable commodity pool

In Staff Letter No. 14-69, DSIO notes that many of those requests for relief contained similar fact patterns: for instance:

- limited partnerships (“LPs”) with two or more general partners (“GPs”), such that only one GP was required to register as a CPO;

- commodity pools organized as LPs or LLCs having, respectively, a GP or managing member affiliated with the pool’s investment manager, such that the investment manager was permitted to serve as the registered CPO in lieu of the GP or managing member; and

- requests from natural persons serving as members of a board of directors or other governing body (“Board”) of a commodity pool domiciled and located outside of the USA.

Note that the staff has generally required the Delegating CPO and the Designated CPO to agree to be jointly and severally liable for any violations of the CEA or the Commission's regulations in these situations, but DSIO clarifies in Staff Letter No. 14-69 that it intends to provide no-action relief to Board members of a commodity pool without requiring them to agree to joint and several liability, provided that they are not affiliated with the Designated CPO (as discussed further below).

Since the number of requests for no-action relief recently has been increasing (likely due, among other factors, to the rescission of CFTC Regulation 4.13(a)(4), which previously provided an exemption from registration for CPOs of many privately offered funds), DSIO is seeking to enhance the efficiency of the CPO registration no-action relief request process in the context of CPO delegation by developing a streamlined process for the submission of such requests.

Summary of the streamlined process

Procedure for requesting relief under the streamlined process

Under the new process, a Delegating CPO must submit a request for relief pursuant to Regulation 140.99 in the form of the attachment to Staff Letter No. 14-69 (a copy of which is attached hereto for reference). The request must include:
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.[4]

The NFA ID Number of the Designated CPO.

The name(s) of the commodity pool(s) with respect to which relief is being sought (note that a single request for relief may be requested by a Delegating CPO with respect to multiple commodity pools).

A representation that the applicable Criteria (as defined below) are met[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[6].

Applicable criteria that must be satisfied to utilize the streamlined process

The following criteria (the “Criteria”) must be satisfied to request CPO registration no-action relief through the streamlined process described above:

(a) Pursuant to a legally binding document[7], the Delegating CPO has delegated to the Designated CPO all of its investment management authority with respect to the commodity pool;

(b) The Delegating CPO does not participate in the solicitation of participants for the commodity pool; and

(c) The Delegating CPO does not manage any property of the commodity pool.

The Designated CPO is registered as a CPO.

The Delegating CPO is not subject to a Statutory Disqualification (see n. 3 supra).

There is 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.

The books and records of the Delegating CPO with respect to the commodity pool are maintained by the Designated CPO in accordance with Regulation 1.31.

If the Delegating CPO and the Designated CPO are each a non-natural person, then one such CPO controls, is controlled by, or is under common control with the other CPO.

If a Delegating CPO is a non-natural person, then such Delegating CPO and the Designated CPO 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.

If a Delegating CPO is a natural person and is not an Unaffiliated Board Member[8], then such Delegating CPO and the Designated CPO 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.

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.

Note that there may be some issues related to satisfying certain of the Criteria, depending upon the particular facts and circumstances involved. For example, commodity pools that have a GP or managing member that is not affiliated with the Designated CPO would not be eligible for the streamlined process. Additionally, directors of pools who are affiliated with or employed by material service providers to a Designated CPO or its affiliates might not be deemed “Unaffiliated Board Members” under the Criteria (see n. 8), thereby necessitating that the parties enter into a joint and several liability agreement before relief can be requested under the streamlined process.
Conclusion

By providing an alternative, streamlined process for requesting no-action relief from CPO registration in the context of delegation arrangements in certain circumstances, the CFTC staff is attempting to facilitate obtaining such relief, particularly since relief may be sought on behalf of multiple commodity pools by means of a single request. However, as noted, the Criteria that must be fulfilled in order to utilize the streamlined process are not necessarily applicable to all CPOs and in all scenarios. Thus, certain CPOs may need to request no-action relief outside of the new, streamlined process or consider alternative fund structures.

Notes


2. CEA Section 1a(10)(A) correspondingly defines the term “commodity pool” to mean: any investment trust, syndicate, or similar form of enterprise operated for the purpose of trading in commodity interests, including any – commodity for future delivery, security futures product, or swap; agreement, contract, or transaction described in section 2(c)(2)(C)(i) of this title or section 2(c)(2)(D)(i) of this title; commodity option authorized under section 6c of this title; or leverage transaction authorized under section 23 of this title.

3. Note that Sections 8a(2) and 8a(3) of the CEA provide for certain specified disqualifications from registration such as, e.g., suspension of prior registration, conviction of certain felonies and misdemeanors, findings of violation of the CEA or the Commission’s regulations, etc. (“Statutory Disqualifications”).

4. If the request is made by a person other than the person on whose behalf the relief is sought, the request must also contain the name, main business address and main business telephone number of the requestor.

5. This representation may be made by an authorized representative of the Delegating CPO(s).

6. This acknowledgement may be made by an authorized representative of the Designated CPO.

7. DSIO notes that the legally binding document could include, but is not limited to, a separate delegation agreement, a document that establishes the pool, or an investment management agreement between the Delegating CPO and the Designated CPO.

8. DSIO defines an “Unaffiliated Board Member” 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.

DSIO further notes that determination of an “interest or relationship” under clause (iii) above will be based on a facts-and-circumstances determination, but could include scenarios where the director is a material service provider or investment counterparty to the Designated CPO or any of its affiliates, or is, or within the past three years was, employed in an executive capacity by, or was a principal or employee of, a material service provider or investment counterparty to, the Designated CPO or any of its affiliates. Since the term “material service provider” is not defined by DSIO, a question arises as to whether directors of a pool who are employed by law firms or director service companies, for instance, would qualify as Unaffiliated Board Members under the Criteria.
Dear Mr. Barnett:

In accordance with the requirements of Commodity Futures Trading Commission (“CFTC” or “Commission”) Regulation 140.99, request is hereby made that the Division of Swap Dealer and Intermediary Oversight (“Division”) not recommend that the Commission commence an enforcement action for failure to register as a commodity pool operator (“CPO”) under Section 4m(1) of the Commodity Exchange Act against each Delegating CPO named herein. This letter is submitted pursuant to CFTC Staff Letter 14-69 and the Delegating CPO(s) named below represent(s) that all of the applicable Criteria are met. Capitalized terms used in this letter have the meaning given to such terms in CFTC Staff Letter 14-69.

1. The name, main business address, main business telephone number, and contact person of the Delegating CPO(s) are as follows:
   a. Name:________________________________.
   b. Main business address:________________________________.
   c. Main business telephone number:________________________.
   d. Contact person:________________________________.

2. The name, main business address, main business telephone number, and contact person of the Designated CPO are as follows:
   a. Name:________________________________.
   b. Main business address:________________________________.
   c. Main business telephone number:________________________.
   d. Contact person:________________________________.

3. The NFA identification number of the Designated CPO is ____________.

4. The name of the commodity pool(s) with respect to which the Delegating CPO(s) is/are requesting relief is/are: _____________________.

Attached as “Exhibit A” to this request is the certification and undertaking required by Commission Regulation 140.99(c)(3). Attached as “Exhibit B” to this request is the acknowledgement of the Designated CPO required by CFTC Staff Letter No. 14-69.

Very truly yours,

[Delegating CPO(s) or Authorized Representative]
EXHIBIT A

Certification and Undertaking pursuant to Regulation 140.99

I hereby certify that the material facts set forth in the attached letter dated _______ are true and complete to the best of my knowledge. If at any time any material representation made in the attached letter ceases to be true and complete, I will ensure that Division staff is informed promptly in writing of all materially changed facts and circumstances.

Very truly yours,

[Delegating CPO(s) or Authorized Representative]

EXHIBIT B

The Designated CPO hereby acknowledges that it has been designated as the registered CPO of the commodity pool(s), as set forth in the attached letter dated _______. The Designated CPO hereby represents that it meets all of the applicable Criteria.

Very truly yours,

[Designated CPO(s) or Authorized Representative]

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