

June 9, 2020

CFTC Adopts Statutory Disqualification Rule

Final Rule Prohibits Any Person Who Has, or Whose Principals Have, in Their Backgrounds a Statutory Disqualification from Claiming an Exemption from CPO Registration under CFTC Rule 4.13

SUMMARY

On June 4, 2020, the U.S. Commodity Futures Trading Commission (the “CFTC” or the “Commission”) unanimously approved adoption of a final rule on “Amendments to Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors: Prohibiting Exemptions under CFTC Rule 4.13 on Behalf of Persons Subject to Certain Statutory Disqualifications” (the “Final Rule”). The Final Rule generally prohibits persons who have, or whose principals have, in their backgrounds any of the statutory disqualifications listed in section 8a(2) of the Commodity Exchange Act (the “CEA” or the “Act”) from seeking to claim a Commodity Pool Operator (“CPO”) registration exemption under CFTC Rule 4.13 (apart from the family office exemption, described in more detail below). Prior to the Final Rule, persons claiming an exemption from CPO registration under CFTC Rule 4.13 were not required to disclose any previous matters that might impact their eligibility or fitness for registration. The Final Rule will require any person, when they first file a notice claiming such exemption, and annually when they affirm such notice, to represent that (subject to limited exceptions) neither the claimant nor any of its principals has in their backgrounds a CEA section 8a(2) disqualification that would require disclosure, if the claimant sought registration with the CFTC.

BACKGROUND

A. CPO REGISTRATION

As amended by the Dodd-Frank Act, section 1a(11) of the CEA defines the term “commodity pool operator” as any person engaged in a business that is of the nature of a commodity pool, investment trust, syndicate,

SULLIVAN & CROMWELL LLP

or similar form of enterprise, and who, with respect to that commodity pool, 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.¹ CEA section 4m(1) generally requires each person who satisfies the CPO definition to register as such with the CFTC.²

CEA section 8a authorizes the Commission to register intermediaries and their associated persons, including CPOs, and also to refuse, condition, or revoke such registration.³ In practice, any pooled investment vehicle—including private funds, many special purpose vehicles and other similar entities—is considered a commodity pool if it invests or trades in “commodity interests,” which is defined under CFTC rules to include futures contracts and swaps (as defined under the CEA). With the expansion of the CEA under the Dodd-Frank Act to include swaps, many entities that had not previously been within the definition of a commodity pool were brought within that definition for the first time. The CFTC has said that a vehicle with even one swap could be a commodity pool.⁴

CEA section 8a(2) lists the offenses for which the Commission may “upon notice, but without a hearing and pursuant to such rules, regulations or orders as the Commission may adopt, ... refuse to register, to register conditionally, or to suspend or place restrictions upon the registration of, any person,” and for which the Commission may revoke the registration of any person “with such a hearing as may be appropriate.”⁵ All applicants for registration are required to submit Form 7-R and all of their natural person principals are required to submit Form 8-R (and to undergo criminal background checks). Forms 7-R and 8-R are in part devised to determine whether applicants (or their principals) have any disqualification enumerated in CEA section 8a(2) in their background. If so, the CFTC states in the Final Rule that their application will generally be denied; however, in practice, there can be an opportunity to discuss this with CFTC staff prior to or in conjunction with seeking registration.

B. EXEMPTIONS FROM CPO REGISTRATION

CFTC Rule 4.13 provides a number of exemptions from registration as a CPO, including an exemption for pools with *de minimis* exposure to commodity interests and “family office” vehicles comprised of investors with defined family or business relationships. CPOs that are eligible for an exemption had not previously been subject to the prohibitions on statutory disqualifications that are applicable to registered CPOs, in part because exempt CPOs do not file Form 7-R and their individual principals do not file Form 8-R.

The CFTC issued a proposed rule on October 18, 2018 (the “Proposed Rule”)⁶ concerning statutory disqualifications from exemptions from CPO and CTA registration. The Proposed Rule amended several aspects of CPO and CTA regulation, but also sought to, in proposed CFTC Rule 4.13(a)(6), require any person claiming an exemption from CPO registration to “represent that neither the person nor any of its principals is subject to any statutory disqualification under section 8a(2) or 8a(3) of the Act, unless such disqualification arises from a matter which was previously disclosed in connection with a previous

SULLIVAN & CROMWELL LLP

application, if such registration was granted, or which was disclosed more than thirty days prior to the claim of this exemption.” The CFTC adopted much of the Proposed Rule in December 2019 but withheld proposed CFTC Rule 4.13(a)(6).

THE FINAL RULE

In the Final Rule, the CFTC has determined to largely adopt CFTC Rule 4.13(a)(6) as proposed with two important distinctions. First, the second exception—“or which was disclosed more than thirty days prior to the claim of this exemption”—was not adopted. Second, the scope has been limited to the statutory disqualifications listed in CEA section 8a(2) (the “Covered Statutory Disqualifications”). The end result is that persons with any Covered Statutory Disqualifications in their background will generally no longer be able to claim CPO exemptions under CFTC Rule 4.13 (other than the family office exemption), absent a separate determination by the Commission under CEA section 8a(2) or CFTC Rule 4.12(a) to exempt such person. This disqualification appears to extend not only to persons claiming exemptions for the first time, but also to persons who currently rely on a CFTC Rule 4.13 exemption and are required by CFTC Rule 4.13(b)(4) to affirm the notice of exemption on an annual basis.

- **Prohibition** – The Final Rule prohibits a person who has, or whose principals have, a Covered Statutory Disqualification in their background from seeking to claim a CPO exemption under CFTC Rule 4.13 (other than the family office exemption, discussed below).
- **Scope** – Only disqualifications listed in CEA section 8a(2) constitute Covered Statutory Disqualifications. Offenses listed in CEA section 8a(3) do not disqualify an applicant for CPO registration exemption.
- **“Principals”** – The CFTC stated in adopting the Final Rule that “the ‘principal’ definition is, generally speaking, limited to those individuals and entities within the CPO who have either management authority and responsibilities, or significant power derived from stock ownership or capital contributions, generally including managing members, company presidents, corporate executives, chief compliance officers, and any legal person who is a ten percent or more shareholder of the person.” The CFTC noted that persons with Covered Statutory Disqualifications may seek individual exemptive relief, based on the Commission’s authority under CFTC Rule 4.12(a) to “exempt any person or any class or classes of persons from any provision of this part 4, if it finds that the exemption is not contrary to the public interest and the purposes of the provisions from which exemption is sought.” The CFTC noted, however, that it expected to grant such exemption requests infrequently, and only when supported by a strong factual and legal basis.
- **Family Offices Exempt** – Exempt family offices will remain exempt from the representation requirement (*i.e.*, family offices may retain their CPO exemption without making the CFTC Rule 4.13(a)(6) representation). The CFTC clarified that, because family offices, by definition and by the substantive requirements of the exemption applicable to them, only serve “family clients,” they generally pose little customer protection risk to the investing public.

SULLIVAN & CROMWELL LLP

- **Compliance Date** – Persons who, as of the Final Rule’s effective date, have filed a notice and are currently relying on an exemption from CPO registration under CFTC Rule 4.13 will be required to comply with the Final Rule when those persons next file a notice of exemption for the 2021 filing cycle, *i.e.*, on March 1, 2021. Persons claiming a CFTC Rule 4.13 exemption for the first time on or after the Final Rule’s effective date (60 days following publication in the Federal Register) will be required to comply with the Final Rule when the person first files a notice of exemption.

* * *

ENDNOTES

- ¹ 7 U.S.C. 1a(11).
- ² 7 U.S.C. 6m(1).
- ³ 7 U.S.C. 12a.
- ⁴ See Commodity Pool Operations and Commodity Trading Advisors: Compliance Obligations; Harmonization of Compliance Obligations for Registered Investment Companies Required To Register as Commodity Pool Operators; Final Rule and Proposed Rule, 77 Fed. Reg. 11252, 11258 (Feb. 24, 2012).
- ⁵ 7 U.S.C. 12a(2).
- ⁶ Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors, 84 Fed. Reg. 67343 (Oct. 18, 2018).

SULLIVAN & CROMWELL LLP

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.

CONTACTS

New York

David J. Gilberg	+1-212-558-4680	gilbergd@sullcrom.com
Wendy M. Goldberg	+1 212-558-7915	goldbergw@sullcrom.com
Kathleen McArthur	+1 212-558-4321	mcarthurk@sullcrom.com
Ryne V. Miller	+1-212-558-3268	millerry@sullcrom.com
Kenneth M. Raisler	+1-212-558-4675	raislerk@sullcrom.com
Rebecca J. Simmons	+1-212-558-3175	simmonsr@sullcrom.com
Alexander Willscher	+1-212-558-4104	willschera@sullcrom.com
Daniel M. Wolf	+1-212-558-4815	wolfd@sullcrom.com

Washington, D.C.

Eric J. Kadel, Jr.	+1-202-956-7640	kadelej@sullcrom.com
Samuel R. Woodall III	+1-202-956-7584	woodalls@sullcrom.com

Melbourne

Waldo D. Jones Jr.	+61-2-8227-6702	jonessw@sullcrom.com
--------------------	-----------------	--

Beijing

Gwen Wong	+86-10-5923-5967	wonggw@sullcrom.com
-----------	------------------	--

Frankfurt

Krystian Czerniecki	+49-69-4272-5525	czernieckik@sullcrom.com
Wolfgang Feuring	+49-69-4272-5511	feuringw@sullcrom.com

Hong Kong

Garth W. Bray	+852-2826-8691	brayg@sullcrom.com
---------------	----------------	--

SULLIVAN & CROMWELL LLP

London

Vanessa K. Blackmore	+44-20-7959-8480	blackmorev@sullcrom.com
----------------------	------------------	--

Paris

William D. Torchiana	+33-1-7304-5890	torchianaw@sullcrom.com
----------------------	-----------------	--

Tokyo

Izumi Akai	+81-3-3213-6145	akaii@sullcrom.com
------------	-----------------	--
