

## COMMODITY FUTURES TRADING COMMISSION

### 17 CFR Part 4

#### **Commodity Pool Operators and Commodity Trading Advisors; Exemption from Requirement To Register for CPOs of Certain Pools and CTAs Advising Such Pools**

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Advance notice of proposed rulemaking.

**SUMMARY:** The Commodity Futures Trading Commission (Commission or CFTC) has received two specific proposals that would provide additional exemption from registration as a commodity pool operator (CPO). It also has received a proposal that would provide additional exemption from registration as a commodity trading advisor (CTA). By this Federal Register release the Commission: (1) is publishing and seeking comment on these proposals (Proposals); and (2) is providing temporary CPO and CTA registration relief (No-Action Relief). To be eligible for the No-Action Relief, a CPO or CTA must meet the criteria specified below.

**DATES:** Comments must be received by **[insert 60 days after date of publication in the Federal Register.]**

**ADDRESSES:** Comments on this advance notice of proposed rulemaking should be sent to Jean A. Webb, Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21<sup>st</sup> Street, N.W., Washington, D.C. 20581. Comments may be sent by facsimile transmission to (202) 418-5528, or by e-mail to [secretary@cftc.gov](mailto:secretary@cftc.gov). Reference should be made to “Advance Notice of Proposed Rulemaking on CPO and CTA Registration Exemptions.”

**FOR FURTHER INFORMATION CONTACT:** Barbara S. Gold, Associate Director, or Christopher W. Cummings, Special Counsel, Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, 1155 21<sup>st</sup> Street, N.W., Washington, D.C. 20581, telephone number: (202) 418-5450 or (202) 418-5445, respectively; facsimile number: (202)

418-5536, or (202) 418-5547, respectively; and electronic mail: bgold@cftc.gov or ccummings@cftc.gov, respectively.

## **SUPPLEMENTARY INFORMATION:**

### **I. Background**

Section 1a(5) of the Commodity Exchange Act (Act) defines the term “commodity pool operator” to mean –

[A]ny person engaged in a business that is of the nature of an 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 any commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility, . . .<sup>1</sup>

Section 4m(1) of the Act<sup>2</sup> provides in relevant part that it is unlawful for any CPO, “unless registered under [the] Act, to make use of the mails or any means or instrumentality of interstate commerce” in connection with its business as a CPO. Thus, except for several narrow exceptions described below, the operator of a collect investment vehicle that trades commodity

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<sup>1</sup> 7 U.S.C. 1a(5) (2000). Section 1a(5) also provides the Commission with authority to exclude persons from the CPO definition.

Commission Rule 4.10(d)(1) correspondingly defines the term “pool” to mean “any investment trust, syndicate or similar form of enterprise operated for the purpose of trading commodity interests.” Commission rules cited to herein are found at 17 CFR Ch. I (2002).

Both the Act and the Commission’s rules issued thereunder can be accessed through the Commission’s website: <http://www.cftc.gov/cftc/cftclawreg.htm>.

<sup>2</sup> 7 U.S.C. 6m(1) (2000).

interest contracts, whether for bona fide hedging purposes or otherwise, must be registered with the CFTC as a CPO.

The Commission has provided certain exceptions to the CPO registration requirement. In 1979, the Commission adopted Rule 4.13, which provides an exemption from CPO registration for the operators of essentially “family, club or small pools,” as those pools are defined in the rule.<sup>3</sup> In addition, the Commission adopted in Rule 4.5 an exclusion from the CPO definition for certain otherwise regulated “eligible persons” with respect to their operation of certain “qualifying entities,” as those terms are defined in the rule, so long as they restrict the extent of their non-bona fide hedge activity in commodity interests as prescribed by the rule.<sup>4</sup>

When the Commission adopted Rule 4.13, there were fewer than a dozen designated commodity interest contracts based on stock indices, interest rates or other financial instruments. Since 1979, however, the Commission has designated, and trading has commenced in, more than 180 commodity interest contracts based on various financial instruments. These contracts frequently have attracted the interest of operators of collective investment vehicles, some of whom have registered with the Commission as CPOs so that they can use commodity interest contracts in their investment and risk management strategies. Others, however, have avoided

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<sup>3</sup> See 44 FR 1918, 1919 (Jan. 8, 1979).

<sup>4</sup> See 50 FR 15868 (April 23, 1985). Rule 4.5 specifies operating criteria that must be complied with to claim the relief available under the rule. Commodity futures and option contracts may be used without limitation for “bona fide hedging transactions and positions,” as that term is defined in Rule 1.3(z)(1). Rule 4.5 also permits up to 5 percent of the liquidation value of a qualifying entity’s portfolio to be committed to establish positions that are non- bona fide hedging transactions and positions. On October 28, 2002 the Commission published for comment a proposed amendment to Rule 4.5 that would provide an alternative criterion for such transactions and positions – i.e., where the notional value of the transactions and positions does not exceed the liquidation value of the entity’s portfolio. 67 FR 65743.

participation in the commodity interest markets. While Rules 4.5 and 4.13 do provide CPO registration relief, their criteria are too restrictive for many operators of collective investment vehicles to meet.

Section 1a(6)(A) of the Act<sup>5</sup> defines the term “commodity trading advisor” to mean any person who –

(i) for compensation or profit, engages in the business of advising others, either directly or through publications, writings or electronic media, as to the value or the advisability of trading in –

(I) any contract of sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market or derivatives transaction execution facility;

(II) any commodity option authorized under section 4c; or

(III) any leverage transaction authorized under section 19;

or

(ii) for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the activities referred to in clause (i).<sup>6</sup>

Section 4m(1) also requires CTAs to register as such with the Commission, and each of that section, Section 4m(3) and Rule 4.14 provides exemption from CTA registration.

Over time, persons who traditionally gave advice to collective investment vehicles solely on securities trading have become interested in providing trading advice to collective investment vehicles on commodity interest contracts based on various financial instruments as well. Absent

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<sup>5</sup> 7 U.S.C. 1a(6)(A) (2002).

<sup>6</sup> Section 1a(6) also excludes certain persons not at issue here from the CTA definition, and provides the Commission with authority to exclude other persons from that definition.

the availability of an exemption, these persons have had to either register with the Commission as CTAs or refrain from providing any such commodity interest advice.

In light of these market developments and changed circumstances, the Commission is seeking comment on the Proposals. By this Federal Register release, the Commission also is asking for input generally on the subject of which CPOs and CTAs the Commission additionally should exempt from registration and what criteria the Commission should use to determine eligibility for exemption.

## **II. The Proposals**

### A. The National Futures Association (NFA) Proposal<sup>7</sup>

#### 1. Introduction

The NFA Proposal would add a CPO registration exemption as well as a corresponding CTA registration exemption to the exemptions currently set forth in Rules 4.13 and 4.14, respectively. The CPO exemption would be available to pool operators that commit a limited amount of pool assets (i.e., 5 percent of liquidation value) to establish commodity interest trading positions, and that restrict participation in the pool to “accredited investors” as defined in Rule 501(a)<sup>8</sup> under the Securities Act of 1933 (Securities Act).<sup>9</sup> The exemption would be set forth in a new paragraph (a)(3) of Rule 4.13, and would require a conforming amendment to paragraph (d) of the rule. The CTA exemption would apply to those persons that advise only

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<sup>7</sup> NFA is a futures association registered as such with the Commission under Section 17 of the Act.

<sup>8</sup> 17 CFR 230.501(a) (2002).

<sup>9</sup> 15 U.S.C. 77a et seq (2000).

pools operated by persons that are eligible for, and have claimed exemption under, the CPO provision described above. It would be set forth in a new paragraph (a)(10) of Rule 4.14.

2. The text of the NFA Proposal

a. The NFA CPO Registration Exemption Proposal reads as follows:

**§ 4.13 Exemption from registration as a commodity pool operator.**

(a) A person is not required to register under the Act as a commodity pool operator if:

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(3)(i) It operates only commodity pools that use commodity futures or commodity options contracts solely for bona fide hedging purposes within the meaning and intent of § 1.3(z)(1); Provided, however, That in addition, with respect to positions in commodity futures and commodity option contracts which do not come within the meaning and intent of 1.3(z)(1), the aggregate initial margin and premiums required to establish such positions for any pool does not exceed five percent of the liquidation value of that pool's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into and such trading is solely incidental to its other trading activity; And Provided further, That in the case of an option that is in-the-money at the time of purchase, the in-the-money amount as defined in § 190.01(x) may be excluded in computing such five percent;

(ii) It has not and does not market participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures or commodity options markets;

(iii) It limits the participants in its pools to accredited investors as defined in Securities Exchange Commission Rule 501;

(iv) It discloses in writing to each prospective participant the purpose of and the limitations on the scope of the commodity futures and commodity options trading in which it will engage;

(v) It submits to such special calls as the Commission may make to require it to demonstrate compliance with the provisions of this § 4.13(a)(3) including but not limited to information on its pools' financial status and position holdings; and

(vi) It maintains all books and records prepared in connection with its activities as a commodity pool operator for a period of five years from the date of preparation and keeps such books and records readily accessible during the first two years of the five year period. All such

books and records shall be open to inspection by any representative of the Commission or the United States Department of Justice.

(b)(1) No person who is exempt from registration as a commodity pool operator under paragraph (a)(1), (a)(2), or (a)(3) of this section and who is not registered as such pursuant to that exemption may, directly or indirectly, solicit, accept or receive funds, securities or other property from any prospective participant in a pool that it operates or that it intends to operate unless, on or before the date it engages in that activity, the person delivers or causes to be delivered to the prospective participant a written statement that must disclose this fact as follows: “The commodity pool operator of this pool is not required to register, and has not registered, with the Commodity Futures Trading Commission. Therefore, unlike a registered commodity pool operator, this commodity pool operator is not required by the Commission to furnish a Disclosure Document, periodic Account Statements, and an Annual Report to participants in the pool.” The person must:

(i) Describe in the statement the exemption pursuant to which it is not registered as a commodity pool operator;

(ii) Provide its name, main business address and main business telephone number on the statement;

(iii) Manually sign the statement as follows: if such person is a corporation, by the chief executive officer, chief financial officer or counterpart thereto; if a partnership, by a general partner; and if a sole proprietorship, by the sole proprietor; and

(iv) By the earlier of seven business days after the date the statement is first delivered to a prospective participant and the date upon which the pool commences trading in commodity interests:

(A) File two copies of the statement with the Commission at the address specified in §4.2; and

(B) File one copy of the statement with the National Futures Association at its headquarters office (Attn: Director of Compliance, Compliance Department).

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(d) If a person exempt from registration under the Act as a commodity pool operator under paragraph (a)(1), (a)(2), or (a)(3) of this section registers as a commodity pool operator, that person must comply with this Part 4 as if such person were not exempt from registration as a commodity pool operator.

2. The NFA CTA Registration Exemption Proposal reads as follows:

**§ 4.14 Exemption from registration as a commodity trading advisor**

(a) A person is not required to register under the Act as a commodity trading advisor if:

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(10)(i) The person's commodity interest trading advice:

(A) Is directed solely to and for the use of commodity pools that meet the requirements of and are operated by a person exempt from registration under § 4.13(a)(3) or are operated by a person excluded from the definition of commodity pool operator under § 4.5;

(B) Is solely incidental to its business of providing investment advice to such pools in instruments that are either exempt from regulation pursuant to the Commission's regulations or excluded from Commission regulation under the Act; and

(C) Employs only such strategies as are consistent with eligibility status under § 4.13(a)(3).

(ii) The person is not otherwise holding itself out as a commodity trading advisor;

(iii) The person submits to such special calls as the Commission may make to provide information on its position holdings; and

(iv) Prior to the date upon which such person intends to engage in business as a commodity trading advisor, the person files a notice of exemption with the Commission.

(A) The notice must provide the name, main business address and main business telephone number of the person filing the notice.

(B) The notice must represent that the person qualifies for exemption under this § 4.14(a)(10) and that it will comply with the criteria of this section.

(C) The notice shall be effective upon filing, Provided, however, That an exemption claimed hereunder shall cease to be effective upon any change which would render the representations made pursuant to paragraph (a)(10)(iii)(B) of this section inaccurate or the continuation of such representations false or misleading.

(v) In the event a person who has filed a notice of exemption under this § 4.14(a)(10) subsequently becomes registered as a commodity trading advisor, the person must file a supplemental notice of that fact.

(vi) Any notice required to be filed hereunder must be:

(A) In writing;

(B) Signed by a duly authorized representative; and

(C) Filed, along with a copy, with the Commission at the address specified in § 4.2.

(D) A copy also must be filed with the National Futures Association at its headquarters office (ATTN: Director of Compliance, Compliance Department).

B. The Managed Funds Association (MFA) Proposal<sup>10</sup>

1. Introduction

The MFA Proposal would provide an additional CPO registration exemption pursuant to a new Rule 4.9. The exemption would be available to pool operators that restrict participation in their pools to “qualified eligible persons” (QEPs) as defined in Rule 4.7 and certain “accredited investors” as defined in Rule 501(a) under the Securities Act. As is set forth below, the MFA Proposal would distinguish between the qualifications that natural persons would be required to meet and the qualifications that non-natural persons would be required to meet.

2. The text of the MFA Proposal

The MFA Proposal reads as follows:

**§4.9. Exemption From Commodity Pool Operator Registration For Certain Persons Operating Privately Offered Pools**

(a) Subject to compliance with all of the provisions of this section, a person is exempt from registration as a commodity pool operator but remains otherwise subject to the jurisdiction of the Commission under the Act, provided that:

(i) interests in all pools that it operates are exempt from registration under the Securities Act of 1933, and such interests are offered and sold without marketing to the public in the United States;

(ii) it reasonably believes that at the time of investment (or, in the case of an existing pool, conversion to an eligible pool as defined herein), all individual investors (and any self-directed employee-benefit plans for such individuals) in all pools that it operates are qualified eligible persons as defined in §4.7;

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<sup>10</sup> MFA is a non-profit membership organization for investment professionals in the hedge fund, futures and alternative investments industries.

(iii) it reasonably believes that at the time of investment (or, in the case of an existing pool, conversion to an eligible pool as defined herein), all entity investors in all pools that it operates are (x) “accredited investors” as defined in 17 CFR 230.501 (a)(1)-(3), (7) and (8) or (y) qualified eligible persons as defined in §4.7; and

(iv) neither the commodity pool operator nor any of its principals is subject to any statutory disqualifications set forth in section 8a(2) or 8a(3) of the Act unless such disqualification arises from a matter which was previously disclosed in connection with an application for registration if such registration was granted or was disclosed more than 30 days prior to the filing of this notice; provided, however, that the commodity pool operator may request that the Commission waive this provision, which waiver may be granted upon a showing of good cause.

(b) Notwithstanding the exemption in (a) above:

(i) the commodity pool operator shall remain subject to the anti-fraud and anti-manipulation provisions of the Act; and

(ii) the commodity pool operator shall, within 180 days of the end of its fiscal year, deliver to the pool participants for each pool it operates under this exemption year-end financial statements certified by an independent public accountant and prepared in accordance with generally accepted accounting principles. In addition, the commodity pool operator shall file two (2) copies of the year-end financial statements with the Commission.

(c) Any person who desires to claim the exemption provided by this section shall file with the Commission a notice of eligibility:

(i) The notice of eligibility must contain the name, main business address and main telephone number of the person claiming the exemption and the name of the pool or pools for which exemption is claimed (an “eligible pool”).

(ii) The notice of eligibility must contain representations that the pool or pools, in order to be eligible pools, will be operated in accordance with the requirements set forth in (a) and (b) of the section.

(iii) The notice of eligibility must contain a representation that the commodity pool operator will submit to such special calls as the Commission may make to require the commodity pool operator to demonstrate compliance with the provisions of §4.9(a) (i)-(iv) and (b)(ii) with respect to the eligible pool. Failure to comply with a special call as described in this paragraph will render the claimed exemption void.

(iv) The notice of eligibility must be filed with the Commission prior to the date upon which the commodity pool operator intends to operate the eligible pool. In the case of a commodity pool operator operating one or more pools that would qualify as eligible pools but with respect to which no notice has been filed, a notice of eligibility may be filed with the

Commission prior to the date upon which the commodity pool operator intends to commence operating the pool as an eligible pool, provided that the commodity pool operator has provided prior notice to pool participants that it intends to convert the pool to an eligible pool under this §4.9 by filing a notice of eligibility with respect to the pool and has given such participants the right to redeem from the pool prior to such filing.

(v) The notice of eligibility shall be effective upon filing, provided that the filing is materially complete.

(d) (i) A commodity pool operator who has claimed exemption hereunder must, in the event that any of the information contained or representations made in the notice of eligibility becomes inaccurate or incomplete, file a supplemental notice with the Commission to that effect which, if applicable, includes such amendments as may be necessary to render the notice of eligibility accurate and complete.

(ii) The supplemental notice required by paragraph (d)(i) of this section shall be filed within fifteen business days after the commodity pool operator becomes aware of the occurrence of such event.

(iii) An exemption claimed hereunder shall cease to be effective 60 days after the commodity pool operator becomes aware of any change which would render inaccurate any of the representations required by subparagraph (c)(ii) or (iii) of this section. During such 60 day period, the commodity pool operator may cure the defects or prepare and file an application to register as a commodity pool operator with the Commission. The filing of an application by the commodity pool operator with the Commission will toll the running of the 60 day period.

(e) A commodity pool operator that operates one or more pools that are not eligible pools under this §4.9 in addition to one or more pools that are eligible pools under §4.9 is, with respect to the eligible pools, exempt from all of the other requirements imposed on a commodity pool operator under the Act, provided that the commodity pool operator complies with this §4.9.

### **III. The No-Action Relief**

#### **A. The Relief**

During the rulemaking process commenced by the publication of this advance notice of proposed rulemaking, the Commission has determined to provide relief through the issuance of No-Action Relief, set forth below. As with other registration relief available to CPOs and CTAs

under CFTC rules, the No-Action Relief must be claimed through the filing of a notice with the NFA and the CFTC, and one-way disclosure of the claim must be made.<sup>11</sup>

#### 1. CPO Registration No-Action Relief

The Commission will not commence any enforcement action against a CPO based upon the failure of the CPO to register as such under Section 4m(1) of the Act, where each pool for which the CPO claims relief under the No-Action Relief meets and remains in compliance with the following criteria:

- a. Participation in the pool is restricted to: “accredited investors” as defined in Rule 501(a) under the Securities Act; “knowledgeable employees” as defined in Rule 3c-5 under the Investment Company Act of 1940;<sup>12</sup> Non-United States persons as defined in CFTC Rule 4.7(a)(1)(iv); and the persons described in CFTC Rule 4.7(a)(2)(viii)(A); and
- b. The aggregate notional value<sup>13</sup> of each such pool’s commodity interest positions, whether entered into for bona fide hedging

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<sup>11</sup> See, e.g., Rules 4.5 and 4.13.

<sup>12</sup> 17 CFR 270.3c-5 (2002).

<sup>13</sup> For this purpose, a CPO should calculate “notional value” for each such futures position by multiplying the size of the futures contract, in contract units, by the current market price per unit, and for each such option position by multiplying the size of the option contract, in contract units, by the strike price. This criterion is patterned on the Commission’s proposed alternative non-hedge operating criterion for Rule 4.5, as discussed above.

The following two examples show the effect of this notional value criterion using two different futures contracts. In each example, the CPO desires to establish the maximum number of contracts permissible under the No-Action Relief. In both examples it is assumed that one-half of the pool’s liquidation value is \$5 million and that the settlement level of the contract is as of September 25, 2002.

With respect to the S&P 500 Stock Price Index futures contract traded on the Chicago Mercantile Exchange, the settlement level was 819.29 and the contract value was \$204,822.50 (819.29 x \$250). This means that the pool could establish 24 S&P 500 Stock Price Index futures contracts ( $\$5,000,000 / 204,822.50 = 24.4$ ).

purposes or otherwise,<sup>14</sup> does not exceed fifty percent of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into.<sup>15</sup>

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With respect to the 10-Year U.S. Treasury Note futures contract traded on the Chicago Board of Trade, the settlement level was 114,160 points and the contract value was \$114,160 (114,160 x 100%). This means that the pool could establish 43 10-Year Treasury Note futures contracts ( $\$5,000,000 / \$114,160 = 43.8$ ).

<sup>14</sup> See Rule 1.3(z)(1).

<sup>15</sup> The operator of a "fund of funds" (an Investor Fund) that indirectly trades commodity interests through participation in one or more funds that directly trades commodity interests (each an Investee Fund) could claim exemption from registration under the No-Action Relief where that Investor Fund trades commodity interests solely through participation in one or more Investee Funds, and the CPO of each such Investee Fund has itself claimed the No-Action Relief. The operator of an Investor Fund that additionally directly trades commodity interests could also claim the No-Action Relief, so long as the portion of the Investor Fund that directly trades commodity interests does not exceed the limit referred to above.

For example, assume that the Investor Fund has a liquidation value of \$1 million, four-fifths of which is invested in four Investee Funds whose operators have claimed the No-Action Relief. With the remaining one-fifth of liquidation value, or \$200,000, the operator of the Investor Fund may have the Fund directly trade commodity interests, provided that the notional value of the Fund's commodity interest positions does not exceed fifty percent of the Fund's liquidation value, adjusted for unrealized profits and unrealized losses on positions directly entered into by the Fund.

If, however, the notional value of those positions exceeded fifty percent of the liquidation value of \$200,000, the operator would only be able to claim the No-Action Relief if the operator knew that the notional value of all of the Investor Fund's commodity interest positions (i.e., those held outright and those held through investment in the four Investee Funds) was fifty percent of the Investor Fund's liquidation value. To be in possession of such information, the operator would need to have direct knowledge of, and immediate access to, the notional value of the commodity interest positions of each Investee Fund. The operator of the Investor Fund could have this knowledge and access where, for example, it was the same person as, or an affiliate of, the CPOs of the Investee Funds.

## 2. CTA Registration No-Action Relief

The Commission will not commence enforcement action against a CTA based upon the failure of the CTA to register as such under Section 4m(1) of the Act, where the CTA meets and remains in compliance with the following criteria:

a. It claims relief from CPO registration under the No-Action Relief and its commodity interest trading advice is directed solely to, and for the sole use of, the pool or pools that it operates;<sup>16</sup> or

b. It is registered as an investment adviser under the Investment Advisers Act of 1940<sup>17</sup> or with the applicable securities regulatory agency of any State, or it is exempt from such registration, or it is excluded from the definition of the term “investment adviser” pursuant to section 202(a)(2) or 202(a)(11) of the Investment Advisers Act of 1940, provided that:

(i) The person’s commodity interest trading advice:

(A) Is directed solely to, and for the sole use of, pools operated by CPOs who claim relief from CPO registration under the No-Action Relief;

(B) Is solely incidental to its business of providing securities advice to each such pool;

(C) Employs only such strategies as are consistent with the “notional test” under the No-Action Relief; and

(ii) The person is not otherwise holding itself out as a CTA.

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<sup>16</sup> This provision is patterned after Rule 4.14(a)(5).

<sup>17</sup> 15 U.S.C. 80b-1 et seq. (2000).

## B. Claim of No-Action Relief

As stated above, the No-Action Relief is not self-executing. Rather, a CPO or CTA eligible for the No-Action Relief must file a Claim to perfect the relief and must make a one-way disclosure to its participants and clients, respectively, whether prospective or existing. A Claim of No-Action Relief will be effective upon filing, so long as the Claim is materially complete.

Specifically, the Claim of No-Action Relief must:

1. State the name, main business address, and main business telephone number of the CPO or CTA claiming the relief;
2. State the capacity (i.e., CPO, CTA or both) and, where applicable, the name of the pool(s), for which the Claim is being filed;
3. Represent that the CPO or CTA qualifies for the No-Action Relief, that it will comply with the criteria of the No-Action Relief, and that it will provide the CFTC-specified disclosure, set forth below;
4. Be signed by the CPO or CTA; and
5. Be filed with the NFA at its headquarters office in Chicago, Illinois (ATTN: Director of Compliance), with a copy to the Commission at its headquarters office in Washington, D.C. (ATTN: Division of Clearing and Intermediary Oversight, Audit and Financial Review Section), prior to the date upon which the CPO or CTA first engages in business that otherwise would require registration as such.

## C. One-Way Disclosure

1. For CPOs

To comply with the terms of a Claim of No-Action Relief that it has filed, a CPO must provide the following disclosure to prospective and existing participants in each pool it operates or intends to operate prior to engaging in activities that otherwise would require it to register as a CPO:

“PURSUANT TO NO-ACTION RELIEF ISSUED BY THE COMMODITY FUTURES TRADING COMMISSION, [NAME OF CPO] IS NOT REQUIRED TO REGISTER, AND IS NOT REGISTERED, WITH THE COMMISSION AS A CPO. AMONG OTHER THINGS, THE NO-ACTION RELIEF REQUIRES THIS CPO TO FILE A CLAIM OF NO-ACTION RELIEF WITH THE NATIONAL FUTURES ASSOCIATION AND THE COMMISSION. IT ALSO REQUIRES THAT THE AGGREGATE NOTIONAL VALUE OF THIS POOL’S COMMODITY INTEREST POSITIONS DOES NOT EXCEED FIFTY PERCENT OF THE LIQUIDATION VALUE OF THE POOL’S PORTFOLIO.

YOU SHOULD ALSO KNOW THAT THIS REGISTRATION NO-ACTION RELIEF IS TEMPORARY. IN THE EVENT THE COMMISSION ULTIMATELY ADOPTS A REGISTRATION EXEMPTION RULE THAT DIFFERS FROM THE NO-ACTION RELIEF, [NAME OF CPO] MUST COMPLY WITH THAT RULE TO BE EXEMPT FROM CPO REGISTRATION. IF [NAME OF CPO] DETERMINES NOT TO COMPLY WITH THAT RULE, IT MUST EITHER REGISTER WITH THE COMMISSION OR CEASE HAVING THIS POOL TRADE COMMODITY INTERESTS.”

2. For CTAs

To comply with the terms of a Claim of No-Action Relief that it has filed, a CTA must provide the following disclosure to each pool it advises or intends to advise prior to engaging in activities that otherwise would require it to register as a CTA:

“PURSUANT TO NO-ACTION RELIEF ISSUED BY THE COMMODITY FUTURES TRADING COMMISSION, [NAME OF CTA] IS NOT REQUIRED TO REGISTER, AND IS NOT REGISTERED, WITH THE COMMISSION AS A CTA. AMONG OTHER THINGS, THE NO-ACTION RELIEF REQUIRES THIS CTA TO FILE A CLAIM OF NO-ACTION RELIEF WITH THE NATIONAL FUTURES ASSOCIATION AND THE COMMISSION. IT ALSO REQUIRES THAT THIS CTA PROVIDE ADVICE SOLELY TO POOLS WHOSE CPOS HAVE FILED A CORRESPONDING CLAIM OF NO-ACTION RELIEF.

YOU SHOULD ALSO KNOW THAT THIS REGISTRATION NO-ACTION RELIEF IS TEMPORARY. IN THE EVENT THE COMMISSION ULTIMATELY ADOPTS A REGISTRATION EXEMPTION RULE THAT DIFFERS FROM THE NO-ACTION RELIEF, [NAME OF CTA] MUST COMPLY WITH THAT RULE TO BE EXEMPT FROM CTA REGISTRATION. IF [NAME OF CTA] DETERMINES NOT TO COMPLY WITH THAT RULE, IT MUST EITHER REGISTER WITH THE COMMISSION OR CEASE PROVIDING COMMODITY INTEREST TRADING ADVICE TO THIS POOL.”

D. Other Matters

1. Effect of Filing a Claim of No-Action Relief

Persons that have filed a Claim of No-Action Relief will be exempt from Commission registration requirements under Section 4m(1) of the Act. Such persons will remain subject, however, to prohibitions in the Act and the Commission's rules against fraud which apply to all CPOs and CTAs regardless of registration status. They also will remain subject to all other relevant provisions of the Act and the Commission's rules which apply to all commodity interest market participants, such as the prohibitions on manipulation and the trader reporting requirements.

## 2. Effect of Final Rulemaking on a Claim of No-Action Relief

Any final action taken by the Commission as a result of this advance notice of proposed rulemaking will supersede the No-Action Relief. In the event the final action differs from the requirements of the No-Action Relief, the Commission will provide CPOs and CTAs with sufficient time within which to comply with such requirements, or, in the event a CPO or CTA is unable or unwilling to so comply, with sufficient time to register with the Commission or to withdraw a previously filed Claim of No-Action Relief and to cease engaging in business as a CPO or CTA.

## 3. Continued Availability of Registration No-Action Relief from Commission Staff

The Commission is aware that there may be existing or subsequently organized CPOs and CTAs that do not meet the criteria of the No-Action Relief, but that nonetheless, under their particular facts or circumstances, merit relief from registration. The Commission also is aware that, in the past, its staff has provided CPO and CTA registration no-action relief on a case-by-case basis. Consistent with that practice, the Commission directs its staff to continue to issue such relief where appropriate facts or circumstances are present.

#### **IV. Request for Comment**

The Commission requests public comment on the exemption criteria of the NFA Proposal, the MFA Proposal, the No-Action Relief, and the following issues:

1. What are the appropriate investor qualifications for participation in collective investment vehicles operated or advised by persons eligible for any new CPO or CTA registration exemption? Should these qualifications vary with the extent of non-hedge commodity interest trading activity? Should these qualifications be the same as those employed in the federal securities laws and the rules of the Securities and Exchange Commission to define financially sophisticated or knowledgeable persons – e.g., “accredited investors,” “qualified purchasers,” and “knowledgeable employees”? Are there any situations where either investor qualifications or the level or type of trading activity should be the sole criterion for exemption?

2. Should persons that qualify for any new CPO or CTA registration exemption be subject to a limit on non-hedge commodity interest trading activity that is higher or lower than the limit in the NFA Proposal? Should there be any limit at all on non-hedge activity by such persons?

3. Should persons that qualify for any new CPO or CTA registration exemption be subject to compliance with the special call, recordkeeping, and NFA notice requirements in the NFA Proposal and/or the special call, financial reporting, and CFTC notice and supplemental notice requirements of the MFA Proposal? Should these persons be subject to compliance with any other requirements and, if so, what should they be?

4. Is there any other form of registration relief that the Commission should propose for CPOs or CTAs and, if so, what is it?

5. How should the Commission's proposal address relief for the operator and/or the advisor of an Investor Fund<sup>18</sup>?

Issued in Washington, D.C. on November \_\_\_\_\_, 2002, by the Commission.

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**Jean A. Webb,**  
Secretary of the Commission

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<sup>18</sup> Staff has received numerous informal inquiries regarding the fund of funds issue. The Commission intends to address this issue in a separate context as it applies more broadly to the managed funds industry. However, it is important to recognize the implications for funds of funds in this release, as discussed above.