



## U.S. COMMODITY FUTURES TRADING COMMISSION

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### PRESS INFORMATION SHEET

#### ***Part 4 – Commodity Pool Operators and Commodity Trading Advisors***

BOCA RATON, FL. -- In a move to ease the regulatory barriers hindering investment in managed futures, the Commodity Futures Trading Commission (CFTC) is proposing major relief from the requirements for registration as a Commodity Pool Operator (CPO) and Commodity Trading Advisor (CTA) for certain operators and advisors of pooled investment vehicles. This relief is intended to encourage and facilitate participation in the commodity interest markets, with the added benefit to all market participants of increased liquidity.

This relief is consistent with the intent of the Commodity Futures Modernization Act of 2000, and with the input the Commission has received in connection with its prior rulemaking initiatives and the September 2002 Roundtable on CPO and CTA Issues. It is intended to allow greater flexibility and innovation and to take into account market developments and the current investment environment by modernizing various Commission requirements.

Currently, the CFTC's rules provide exemptions for operators of certain very small pools and for certain otherwise regulated entities, such as mutual funds, insurance companies and pension funds. The proposed amendments would expand the relief available to certain persons currently excluded from the CPO definition; provide additional exemptions from the requirement to register as a CPO or CTA; facilitate communications by CPOs and CTAs with prospective and existing pool participants and clients; and address duplicative regulatory requirements for "master/feeder fund" structures.

In order to provide immediate relief during the rulemaking process, the Commission is continuing to provide temporary CPO and CTA no-action relief to persons who meet the requirements set forth in the *Federal Register* release announcing the proposed rule.

#### **Background**

##### *Greater Availability of Exclusion from CPO Definition*

The Commission is proposing to amend Rule 4.5, which provides an exclusion from the CPO definition for certain otherwise-regulated persons, such as investment companies registered with the SEC. In light of the absence of trading restrictions in one of the Commission's proposals for exemption from CPO registration (discussed below), the Commission is proposing to remove the limits on commodity interest trading that currently are required under Rule 4.5.

##### *Additional CPO and CTA Registration Exemptions*

The Commission is proposing two new CPO registration exemptions. One of these new exemptions, proposed Rule 4.13(a)(4), would apply to CPOs who restrict participation in their pools to certain sophisticated investors. Because of the high level of sophistication of their pools' participants, these CPOs would have no limits on the amount of commodity interest trading in which their pools could engage. The other new exemption, proposed Rule 4.13(a)(3), would apply to CPOs who restrict participation in their pools to accredited investors. Because of this lower level of investor sophistication for the latter group, these pools would be subject to a trading limitation: they could use up to two percent of their assets to establish commodity interest positions or they could enter into commodity interest contracts whose notional value, as defined in the proposed rule, did not exceed 50 percent of the pools' liquidation value. The Commission similarly is proposing in Rule 4.14(a)(8) that persons who advise only these type of pools would be exempt from CTA registration.

*Facilitating Communications with Pool Participants and Advisory Clients.*

The Commission is proposing to amend its solicitation requirements for CPOs and CTAs. Currently, Rules 4.21 and 4.31 require delivery of a prescribed Disclosure Document in advance of, or contemporaneously with, the solicitation of prospective pool participants or advisory clients. The Commission is proposing to amend these rules to permit certain information to be furnished to prospective participants and clients in advance of a Disclosure Document – so long as that material is consistent with the CPO's or CTA's obligations under federal and state authorities.

The Commission is proposing to amend Rule 4.22, which requires CPOs to provide financial information about their pools' operations to their participants. The amendment would permit CPOs to electronically distribute periodic account statements, with a participant's consent, thereby codifying prior staff guidance and conforming to ways in which account information is permitted to be distributed by other Commission registrants.

*Addressing Duplicative Regulatory Requirements for "Master/Feeder" Fund Structures.*

Where a CPO operates a pool that is a participant in another pool operated by the same CPO, current disclosure and reporting requirements would require the CPO to disclose and report to itself. The Commission is proposing to amend Rules 4.21 and 4.22 to eliminate the duplicative requirements that arise in this type of situation. This proposal would codify prior staff advice in this area.

*Coordinating CFTC Requirements With Requirements of Other Regulators.*

Section 4m(1) of the Commodity Exchange Act exempts from CTA registration a person who advises no more than 15 persons over any 12-month period and who does not generally hold himself out to the public as a CTA. Commission staff has required advisors to "look through" entities they advise, such as partnerships or corporations, and to count each limited partner or shareholder to determine the number of "persons" advised. In proposed Rule 4.14(a)(10), the Commission is proposing to eliminate this "look through" requirement, consistent with the requirements under the corresponding federal securities law exemption for investment advisers. The Commission is not, however, proposing to interpret or otherwise affect the second prong of the Section 4m(1) exemption test concerning holding oneself out to the public as a CTA.

**RIN 3038-AB97**

**COMMODITY FUTURES TRADING COMMISSION**

**17 CFR Part 4**

**Additional Registration and Other Regulatory Relief for Commodity Pool Operators and Commodity Trading Advisors**

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Proposed rules.

**SUMMARY:** The Commodity Futures Trading Commission (Commission or CFTC) is proposing to amend Rule 4.5, which provides an exclusion from the definition of the term “commodity pool operator” (CPO) for certain persons, and Rules 4.13 and 4.14, which provide exemption from CPO and commodity trading advisor (CTA) registration, respectively, for certain other persons, so as to expand the availability of the relief provided by these rules. The Commission also is proposing rule amendments to facilitate communications by CPOs and CTAs, including proposals that would: (1) permit certain communications prior to Disclosure Document distribution; (2) relieve CPOs from duplicative disclosure and reporting requirements in the “master/feeder fund” context; (3) establish criteria for CPOs to distribute periodic Account Statements electronically; and (4) harmonize the various signature requirements of Part 4. Further, the Commission is affirming, with certain modifications, the no-action relief it previously has issued with respect to the trading criteria of Rule 4.5 for certain persons and the need to register as a CPO or CTA for certain other persons.

**DATES:** Comments must be received by [insert date 45 days after date of publication in the FEDERAL REGISTER].

**ADDRESSES:** Comments on the proposed rules should be sent to Jean A. Webb, Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21<sup>st</sup> Street, N.W., Washington, DC 20581. Comments may be sent by facsimile transmission to (202) 418-5528, or by email to [secretary@cftc.gov](mailto:secretary@cftc.gov). Reference should be made to “Proposed Rules for CPO and CTA Registration and Other Regulatory Relief.”

**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, DC 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](mailto:bgold@cftc.gov) or [ccummings@cftc.gov](mailto:ccummings@cftc.gov), respectively.

**SUPPLEMENTARY INFORMATION:**

**Table of Contents**

**I. Background**

- A. Statutory and Regulatory Authorities**
- B. The Prior Rule 4.5 Proposal**
- C. The Advance Notice of Proposed Rulemaking (ANPR)**
- D. Roundtable on CPO and CTA Issues**

**II. Comments on the Prior Rulemaking Activities**

- A. Comments on the Prior Rule 4.5 Proposal**
- B. Comments on the ANPR**

### **III. The Proposals**

**A. Proposed Amendment to Rule 4.5: Deleting Trading Criteria for Exclusion from the CPO Definition**

**B. Proposed Amendments to Rule 4.13: Expanding and Adding CPO Registration Exemptions**

- 1. Proposed Amendments to Rule 4.13(a)(2): Expanding the current exemption**
- 2. Proposed Rule 4.13(a)(3): Adding a limited trading exemption**
- 3. Proposed Rule 4.13(a)(4): Adding an exemption where pool participants meet specified sophistication criteria**
- 4. Additional provisions under Rule 4.13**
- 5. Alternative proposal for relief**

**C. Proposed Amendments to Rule 4.14: Expanding and Adding CTA Registration Exemptions**

- 1. Proposed Amendments to Rule 4.14(a)(8)**
  - a. Exemption for state-registered investment advisers (IAs)**
  - b. Exemption where advice is provided to foreign funds**
  - c. Exemption where advice is to Rule 4.13(a)(3) and 4.13(a)(4) pools**
- 2. Proposed Rule 4.14(a)(10): Counting Legal Organizations as a Single “Person”**

**D. Proposed Amendments to Rules 4.21, 4.22 and 4.31**

- 1. Permitting communications prior to Disclosure Document distribution**
- 2. Removing duplicative requirements in the “master/feeder fund” context**
- 3. Distributing Account Statements electronically**

**4. Providing facsimile signatures on Account Statements and Annual Reports**

**5. Conforming signature requirements**

**IV. Temporary No-Action Relief**

**A. Temporary No-Action Relief for Rule 4.5 Eligible Persons**

**B. CPO and CTA Temporary Registration No-Action Relief**

**1. Relief for CPOs**

**a. In General**

**b. CPOs who operate “Funds-of-Funds”**

**2. Relief for CTAs**

**3. Claim of Registration No-Action Relief**

**4. One-Way Disclosure by CPOs and CTAs**

**5. Effect of Filing a Claim of No-Action Relief**

**a. For CPOs**

**b. For CTAs**

**C. Other Matters**

**1. Effect of Final Rulemaking on No-Action Relief**

**2. Continued Availability of No-Action Relief from Commission Staff**

**V. Other Matters**

**A. Regulatory Flexibility Act**

**B. Paperwork Reduction Act**

**C. Cost-Benefit Analysis**

**I. Background**

#### A. Statutory and Regulatory Authorities

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 the narrow exceptions currently provided in Rules 4.5 and 4.13, the operator of a collective investment

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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.” Unless otherwise noted, 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 web site: <http://www.cftc.gov/cftc/cftclawreg.htm>.

CFTC Staff Letters from 1995 on can be accessed through the Commission’s web site: <http://www.cftc.gov/opaletters.htm>.

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

vehicle that trades commodity interest contracts, whether for bona fide hedging purposes<sup>3</sup> or otherwise, must be registered with the CFTC as a CPO.<sup>4</sup>

Section 1a(6)(A) of the Act 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>5</sup>

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<sup>3</sup> The Commission’s definition of bona fide hedging is set forth in Rule 1.3(z).

<sup>4</sup> Rule 4.5 provides 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-hedging activity in commodity interests as prescribed by the rule. As is discussed below, the Commission proposed to amend Rule 4.5, and by this Federal Register release is proposing further amendment of Rule 4.5.

Rule 4.13 provides an exemption from CPO registration for the operators of essentially “family, club or small pools,” as those pools are described in the rule. See 44 FR 1918, 1919 (Jan. 8, 1979). As is discussed below, the Commission also is proposing to amend Rule 4.13.

<sup>5</sup> 7 U.S.C. 1a(6)(A) (2000).

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

Section 4m(1) of the Act also requires CTAs to register as such with the Commission and, along with Section 4m(3) and Rule 4.14, provides exemption from CTA registration.<sup>6</sup>

If a person is exempt from registration as a CPO or CTA, its associated persons (APs) are not required to register as such. Further, neither the exempt CPO or CTA, nor any of its APs, is required to become a member of a registered futures association.

Generally, CPOs and CTAs who are, or who are required to be, registered with the Commission, must provide prospective pool participants or advisory clients, as the case may be, with a Disclosure Document containing specified information<sup>7</sup> – e.g., the business background of the CPO or CTA and its principals, past performance, fees and other expenses, and conflicts of interest – and they must make and keep specified books and records.<sup>8</sup> These CPOs also must provide unaudited periodic financial reports and certified annual reports to participants in their pools.<sup>9</sup> Additionally, regardless of registration status, all persons who come within the CPO or CTA definition are subject to certain operational<sup>10</sup> and advertising requirements<sup>11</sup> under Part 4,

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<sup>6</sup> As is discussed below, the Commission similarly is also proposing to amend Rule 4.14.

<sup>7</sup> Rule 4.21 for CPOs and Rule 4.31 for CTAs.

<sup>8</sup> Rule 4.23 for CPOs and Rule 4.33 for CTAs.

<sup>9</sup> Rule 4.22.

<sup>10</sup> Rule 4.20 for CPOs and Rule 4.30 for CTAs.

<sup>11</sup> Rule 4.41.

While Rules 4.7 and 4.12(b) provide relief for certain registered CPOs from the Disclosure Document, periodic and annual reporting, and recordkeeping requirements of Rules 4.21, 4.22, and 4.23, they do not affect the applicability of Rules 4.20 and 4.41 to these CPOs.

to all other provisions of the Act and the Commission's rules prohibiting fraud that apply to CPOs and CTAs, and to all other relevant provisions of the Act and the Commission's rules that apply to all commodity interest market participants, such as the prohibitions on manipulation and the trade reporting requirements.

B. The Prior Rule 4.5 Proposal

Rule 4.5 makes available to certain persons (eligible persons) an exclusion from the definition of CPO with respect to their operation of certain entities (qualifying entities) that would otherwise be treated as commodity pools under the Act, but that are already subject to extensive operating requirements of another federal or state regulator.<sup>12</sup> These eligible persons and their qualifying entities include: (1) investment companies registered as such under the Investment Company Act of 1940 (ICA); (2) state-regulated insurance companies with respect to their operation of insurance company separate accounts; (3) state- or federally-regulated financial depository institutions with respect to their operation of separate units of investment; and (4) trustees, named fiduciaries and certain designated fiduciaries of or employers maintaining pension plans subject to Title I of the Employee Retirement Income Security Act of 1974 with respect to the operation of such plans.<sup>13</sup> In order to claim exclusion from the CPO definition under Rule 4.5, an eligible person must file a Notice of Eligibility with the National

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Similarly, CTAs who have claimed relief under Rule 4.7 continue to remain subject to Rules 4.30 and 4.41.

<sup>12</sup> See, generally, 50 FR 15868 (Apr. 23, 1985) for background information on Rule 4.5.

<sup>13</sup> Rules 4.5(a) and (b).

Futures Association (NFA)<sup>14</sup> and the Commission.<sup>15</sup> The Notice must contain specified representations about how the person will operate the qualifying entity, including, as is discussed below, a requirement to restrict the amount of the entity's commodity interest trading with respect to its non-hedging activity.

Based upon its staff's experience in administering Rule 4.5, the Commission has made various revisions to the rule subsequent to the rule's initial adoption. These revisions have expanded the range of persons eligible to claim relief under the rule<sup>16</sup> and the trading strategies that may be undertaken in accordance with the rule.<sup>17</sup> Based upon staff's most recent experience with Rule 4.5, the Commission published for public comment a proposed revision to the non-hedge operating criteria and, in connection therewith, the Commission issued temporary no-action relief (Prior Rule 4.5 Proposal).<sup>18</sup> Based upon further consideration, and in connection

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<sup>14</sup> NFA is a futures association registered as such with the Commission under section 17 of the Act, 7 U.S.C. 21 (2000).

<sup>15</sup> Rule 4.5(c).

Additionally, Rule 4.5 provides that certain pension plans are not commodity pools. Because this exclusion is self-executing, no notice must be filed to claim it. Accordingly, the amendment to Rule 4.5(c) that the Commission is today proposing does not apply to these plans or their operation. See Rule 4.5(a)(4)(i)-(iv).

<sup>16</sup> See 58 FR 43791 (Aug. 18, 1993). The Commission also has expanded the class of persons who are "non-pools" under Rule 4.5. See 65 FR 24127 (Apr. 25, 2000).

<sup>17</sup> See 58 FR 6371 (Jan. 28, 1993). The original limitation of the rule encompassed all commodity interest trading. Currently, unlimited hedging may be engaged in under the rule, while non-hedging activity remains limited.

<sup>18</sup> 67 FR 65743 (Oct. 28, 2002). Both the Prior Rule 4.5 Proposal and the comment letters the Commission received thereon may be accessed through [www.cftc.gov/foia/fedreg02/foia.fedreg02.htm#SECTIONA](http://www.cftc.gov/foia/fedreg02/foia.fedreg02.htm#SECTIONA).

with the CPO registration exemptions it is proposing below, by this Federal Register release the Commission is withdrawing the Prior Rule 4.5 Proposal and, in lieu thereof, is proposing another amendment to Rule 4.5. Pending the conclusion of the instant rulemaking, the no-action position the Commission issued in connection with the Prior Rule 4.5 Proposal will, subject to clarification as discussed below in Section IV of this release, remain in effect.

### C. The Advance Notice of Proposed Rulemaking (ANPR)

To address certain market developments and changed circumstances applicable to persons who do not qualify for an exclusion from the CPO definition under Rule 4.5 or an exemption from CPO or CTA registration under the existing statutory and regulatory framework, the Commission issued the ANPR.<sup>19</sup> As the Commission stated:

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 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.

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Over time, persons who traditionally gave advice to collective investment vehicles solely on securities trading have

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<sup>19</sup> 67 FR 68785 (Nov. 13, 2002). Both the ANPR and the comment letters the Commission received thereon may be accessed through: [www.cftc.gov/foia/fedreg02/foiafedreg02.htm#SECTIONA](http://www.cftc.gov/foia/fedreg02/foiafedreg02.htm#SECTIONA).

become interested in providing trading advice to collective investment vehicles on commodity interest contracts based on various financial instruments as well. Absent 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. 67 FR 68785, 68786.

By the ANPR, the Commission published for public comment two proposals it had received that would provide additional exemptions from CPO registration (one of these also would provide an additional exemption from CTA registration). These proposals were submitted by NFA and the Managed Funds Association (MFA).<sup>20</sup> NFA proposed: (1) an exemption from CPO registration where the operator restricts its pool's non-hedge commodity interest positions to a limited amount of pool assets (i.e., it may commit no more than 5 percent of the pool's liquidation value to establish such positions), and restricts its pool's participants to "accredited investors" as defined in Rule 501(a)<sup>21</sup> under the Securities Act of 1933 (Securities Act);<sup>22</sup> and (2) an exemption from CTA registration for those persons that advise pools operated by CPOs that have claimed either an exemption from registration under the proposed NFA rule or an exclusion from the CPO definition under Rule 4.5 (NFA Proposal). MFA proposed an exemption from CPO registration for pool operators that restrict participation in their pools to certain "qualified eligible persons" (QEPs) as defined in Rule 4.7 and certain "accredited investors" (MFA

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<sup>20</sup> MFA is a non-profit membership organization for investment professionals in the hedge fund, futures and alternative investments industries.

<sup>21</sup> 17 CFR 230.501(a) (2002).

<sup>22</sup> 15 U.S.C. 77a et seq. (2000).

Proposal). By the ANPR the Commission also issued temporary registration no-action relief for certain CPOs and CTAs.<sup>23</sup>

Based upon the comments received on the ANPR,<sup>24</sup> and as a result of its own further consideration, the Commission is proposing herein CPO and CTA registration exemptions based on the NFA and MFA Proposals. Pending the conclusion of this rulemaking, the CPO and CTA registration no-action relief that the Commission issued in connection with its publication of the ANPR will, subject to modification and clarification as discussed below, remain in effect.

#### D. Roundtable on CPO and CTA Issues (Roundtable)

Section 125 of the Commodity Futures Modernization Act of 2000 (CFMA)<sup>25</sup> required the Commission to “conduct a study of the [Act] and the Commission’s rules, regulations and orders governing the conduct of persons required to be registered under the Act.” Pursuant to this directive, the Commission conducted such a study, and in June 2002, issued its findings in a “Report on the Study of the Commodity Exchange Act and the Commission’s Rules and Orders Governing the Conduct of Registrants under the Act (Report).”<sup>26</sup> In September 2002, the Commission held a “Roundtable on CPO and CTA Issues” to address, among others, issues identified in the Report relating to overlapping regulatory jurisdiction faced by members of the

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<sup>23</sup> See 67 FR 68786, 68788-89.

<sup>24</sup> Section II of this Federal Register release discusses the comments the Commission received on the ANPR, as well as the comments the Commission received on the Prior Rule 4.5 Proposal.

<sup>25</sup> Pub. L. No. 106-554, Appendix E, §125, 114 Stat. 2763A-365 (2000).

<sup>26</sup> The Report may be accessed through [www.cftc.gov/files/opa/opaintermediarystudy.pdf](http://www.cftc.gov/files/opa/opaintermediarystudy.pdf).

managed funds industry.<sup>27</sup> As a result of the testimony provided at the Roundtable, and also based on prior staff activity in this area, by this Federal Register release the Commission is proposing additional regulatory relief for CPOs and CTAs. This relief would: (1) permit certain communications by CPOs and CTAs with prospective and existing pool participants and advisory clients prior to Disclosure Document distribution; (2) relieve CPOs from duplicative disclosure and reporting requirements in the “master/feeder fund” context; (3) establish criteria for CPOs to distribute periodic Account Statements electronically; and (4) harmonize the various signature requirements of Part 4. Each of the proposals is discussed below.

## **II. Comments on the Prior Rulemaking Activities**

### A. Comments on the Prior Rule 4.5 Proposal

The Commission received five comment letters in response to the Prior Rule 4.5 Proposal.<sup>28</sup> All of the commenters supported the proposed amendment, with various commenters stating that it would provide increased trading flexibility under Rule 4.5 in general and accommodate security futures products in particular. Commenters did, however, request certain clarifications of the terms and application of the non-hedge tests employed in the Prior Rule 4.5 Proposal – e.g., suggesting that “aggregate notional value” be determined on a net basis and that, at all times, qualifying entities should be able to satisfy one test or the other. As is discussed

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<sup>27</sup> Comments received in connection with the Roundtable may be accessed through [www.cftc.gov/opa/press02/opa4700-02.htm](http://www.cftc.gov/opa/press02/opa4700-02.htm).

<sup>28</sup> Letters were submitted by: a registered futures association; an investment company trade association; a bar association; a contract market; and an investment adviser.

One commenter suggested that the Commission adopt specified additional categories of eligible persons and non-pools under Rule 4.5. This suggestion is, however, outside the scope of this proposed rulemaking. The Commission nonetheless intends to consider it in the future.

below in this Federal Register release, the Commission has taken these requests for clarification into account in both the rules it is proposing and the no-action positions it is maintaining.

#### B. Comments on the ANPR

The Commission received twenty-three comment letters in response to the ANPR.<sup>29</sup> All of these commenters similarly encouraged Commission efforts to expand registration exemptions for CPOs and CTAs. While commenters generally supported both the NFA and MFA Proposals, several specifically urged adoption of the MFA Proposal, stating that it would bring more participants into the commodity interest markets. Additionally, one commenter suggested that the Commission adopt registration exemptions based on the temporary registration no-action relief issued in connection with the ANPR, and several commenters suggested that the Commission adopt the NFA Proposal, the MFA Proposal and the temporary registration no-action relief. Commenters offered various recommendations as to CPO and CTA registration exemption rules the Commission should adopt in furtherance of the ANPR. In particular, commenters requested clarification of the application of exemptive relief in the fund-of-funds context. The Commission similarly has taken these comments into account in the proposals it is making below.

### **III. The Proposals**

The relief the Commission is proposing today is consistent with the purpose and intent of the CFMA, and with the input the Commission has received in connection with its prior

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<sup>29</sup> Letters were submitted by: a registered futures association; two futures industry trade associations; four hedge funds and their managers; one exempt CPO; one national securities exchange; two contract markets; seven law firms; two attorneys; two bar associations; and one certified public accounting firm.

initiatives (i.e., the Prior Rule 4.5 Proposal, the ANPR, and the Roundtable). Accordingly, it is intended to allow greater flexibility and innovation, and to take into account market developments and the current investment environment, by modernizing the requirements for determining who should be excluded from the CPO definition, and who should remain within the CPO and CTA definitions but be exempt from registration. Thus, this relief is intended to encourage and facilitate participation in the commodity interest markets by additional collective investment vehicles and their advisers, with the added benefit to all market participants of increased liquidity.

A. Proposed Amendment to Rule 4.5: Deleting Trading Criteria for Exclusion from the CPO Definition.

Currently, Rule 4.5(c)(2)(i) provides that the Notice of Eligibility must contain a representation that the eligible person will operate the qualifying entity such that the entity:

Will use commodity futures or commodity options contracts solely for bona fide hedging purposes within the meaning and intent of [Rule] 1.3(z)(1); Provided, however, That in addition, with respect to positions in commodity futures or commodity option contracts which do not come within the meaning and intent of [Rule] 1.3(z)(1), a qualifying entity may represent that the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into; 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 [Rule] 190.01(x) may be excluded in computing such 5 percent.

This representation has come to be known as the "Five Percent Test."

Because futures margins have generally been set at levels near or below 5 percent of contract value, the Five Percent Test has permitted the notional value of non-hedging commodity futures and option positions to approximate the liquidation value of an entity's portfolio. Recently, however, eligible persons and qualifying entities have expressed concern to Commission staff over the Five Percent Test, because margin levels for certain stock index futures have come to significantly exceed 5 percent of contract value, thereby limiting the use of such contracts in non-hedging strategies to a much greater extent than other types of contracts with lower margins. They also have expressed concern that a similar constraint could arise with respect to security futures contracts, because the required margin for security futures is 20 percent of contract value.<sup>30</sup> In response to these concerns, the Commission proposed to amend Rule 4.5 by adding as an alternative to the Five Percent Test a limitation based on the notional value of non-hedge positions, i.e., that:

the aggregate notional value of [non-hedge commodity interest] positions does not exceed the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into. For [this purpose], the term 'notional value' shall be calculated for each such futures position by multiplying the size of the contract, in contract units, by the current market price per unit and for each such option position by multiplying the size of the contract, in contract units, by the strike price per unit.<sup>31</sup>

However, by this Federal Register release and in furtherance of the ANPR, the Commission is proposing to provide an additional exemption from CPO registration relief based

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<sup>30</sup> See CFTC Rule 41.45(b)(1) and Securities and Exchange Commission (SEC) Rule 242.403(b)(1), 67 FR 53146, 53174 and 53179, respectively (Aug. 14, 2002).

<sup>31</sup> 67 FR 65743, 65746.

solely on pool participant sophistication, without any requirement that the pool operator must be subject to another regulatory scheme and without any restriction whatsoever on the purpose or scope of the pool's commodity interest trading.<sup>32</sup> Since the eligible persons and qualifying entities of Rule 4.5 are, as stated in the title of the rule, "otherwise regulated," the Commission believes that, like the unregulated CPOs for whom it is proposing relief below, these persons and entities may not need to be subject to any commodity interest trading criteria to qualify for relief under Rule 4.5. The Commission further believes that the absence of such criteria may render obsolete the current disclosure requirement in Rule 4.5(c)(2)(iii).

Accordingly, the Commission is proposing to delete paragraphs (c)(2)(i) and (c)(2)(iii) from Rule 4.5. This would result in paragraphs (c)(2)(ii) and (c)(2)(iv) of the rule, which concern the other representations that the Notice of Eligibility must contain, being redesignated as paragraphs (c)(2)(i) and (c)(2)(ii), respectively. Thus, the Rule 4.5 operating criteria would continue to include: (1) a prohibition against marketing a qualifying entity as a commodity pool or otherwise as a vehicle to trade commodity interests; and (2) a requirement to submit to special calls to demonstrate compliance with eligibility for relief under Rule 4.5. The Commission believes it is appropriate to maintain the marketing restriction because, unlike the case with the proposed CPO registration exemption, members of the retail public may participate in the trading vehicles subject to Rule 4.5. The Commission nonetheless requests comment on the merits of maintaining current Rule 4.5(c)(2)(ii) (which would be redesignated as Rule 4.5(c)(2)(i)).

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<sup>32</sup> The Commission is proposing this relief, which is based on the MFA Proposal, in new Rule 4.13(a)(4), discussed below.

## B. Proposed Amendments to Rule 4.13: Expanding and Adding CPO Registration

### Exemptions

#### 1. Proposed Amendments to Rule 4.13(a)(2): Expanding the current exemption

Rule 4.13(a)(2) currently provides that a person is exempt from registration as a CPO if:

(2)(i) The total gross capital contributions it receives for units of participation in all of the pools that it operates or that it intends to operate do not in the aggregate exceed \$200,000; and

(ii) None of the pools operated by it has more than 15 participants at any time. For purposes of computing the number of participants for paragraph (a)(2)(ii) of this section, the following participants shall be excluded:

(A) The pool's operator, commodity trading advisor, and the principals thereof; and

(B) Any relative, spouse or relative of such spouse living in the same household as such participant.

The Commission adopted the exemptive criteria of Rule 4.13(a)(2) in 1981.<sup>33</sup> In light of the rate of inflation in the more than twenty years since that time and Commission staff's experience in administering Rule 4.13(a)(2), the Commission is proposing various amendments that will update and clarify the rule, making it available to more persons.

First, the Commission is proposing to increase the total of the gross capital contributions criterion under Rule 4.13(a)(2) to \$400,000 from \$200,000.<sup>34</sup> This proposed amount (\$400,000)

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<sup>33</sup> See 46 FR 26004, 26006 (May 8, 1981).

<sup>34</sup> One of the commenters on the ANPR suggested a similar increase.

reflects adjustments to the current amount (\$200,000) based on the Consumer Price Index published by the Bureau of Labor Statistics of the United States Department of Labor.<sup>35</sup>

Second, the Commission is proposing to expand the range of participants excluded from the “no more than 15 participants” limitation of the rule and to clarify that the contributions of these participants do not count toward the capital contributions limit of the rule.<sup>36</sup> This

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<sup>35</sup> See <http://data.bls.gov/cgi-bin/cpicalc.pl>, where the “CPI Inflation Calculator” made available on that page (for values less than \$10,000) determines that \$2,000 in 1981 has the same buying power as \$3958.20 in 2002.

<sup>36</sup> See CFTC Staff Letter 99-41 (Aug. 27, 1999), where, in permitting a CPO to exclude the contributions of itself and its spouse in determining whether the contribution limit (of \$200,000) of Rule 4.13(a)(2) has been met, Commission staff explained:

Paragraph (a)(2)(i) of Rule 4.13 does not address whether the gross capital contributions to a pool by its operator or advisor should be excluded from the \$200,000 limit in the rule, even though a pool’s operator, advisor, and the principals thereof specifically are excluded from the “no more than fifteen participants” limit in paragraph (a)(2)(ii) of the rule. That paragraph provides that for the purposes of computing the number of participants allowable in a pool for which the operator thereof seeks to claim an exemption from registration under Rule 4.13(a)(2), the pool’s operator, advisor and their principals are excluded. This provision was patterned after Rule 501(e)(1)(i) under the Securities Act of 1933 (‘the ’33 Act’), which provides that for the purposes of computing the number of non-accredited purchasers allowed to participate in an exempt offering under Rule 506 under the ’33 Act, ‘the following purchasers shall be excluded: any relative, spouse or relative of the spouse of a purchaser who has the same principal residence as the purchaser.’ Since Rule 506 provides an exemption from the registration of securities otherwise required under the ’33 Act for limited offers and sales without regard to the dollar amount of the offering, the exemptive rules under the ’33 Act need not, and do not, make any mention of excluding the capital contributions of persons who are excluded from the computation of non-accredited purchasers. (Footnotes omitted).

clarification would require a reorganization of Rule 4.13(a)(2) such that, as proposed, the rule would provide that a person is exempt from CPO registration if:

(2)(i) None of the pools operated by it has more than 15 participants at any time; and

(ii) The total gross capital contributions it receives for units of participation in all of the pools it operates or that it intends to operate do not in the aggregate exceed \$400,000.

(iii) For the purposes of determining eligibility for exemption under paragraph (a)(2) of this section, the person may exclude the following participants and their contributions:

(A) The pool's operator, commodity trading advisor, and the principals thereof;

(B) A child, sibling or parent of any of these persons;

(C) The spouse of any person specified in paragraph (a)(2)(iii)(A) or (B) of this section; and

(D) Any relative of a person specified in paragraph (a)(2)(iii)(A), (B) or (C) of this section, its spouse or a relative of its spouse, who has the same principal residence as such person.

## 2. Proposed Rule 4.13(a)(3): Adding a limited trading exemption

Proposed Rule 4.13(a)(3) is based on the NFA Proposal and also on the Commission's Prior Rule 4.5 Proposal. It would provide an exemption from CPO registration where the pool a person operates engages in a limited amount of commodity interest trading -- i.e., by committing a limited amount of the liquidation value of the pool's portfolio to establish commodity interest trading positions, whether entered into for bona fide hedging purposes or otherwise, or where the aggregate net notional value of the pool's commodity interest trading does not exceed fifty percent of the pool's liquidation value. The Commission's proposal does, however, differ from

the NFA Proposal in certain respects. It would limit the amount that could be committed to establish commodity interest positions to two percent of the liquidation value of a pool's portfolio, whereas the NFA Proposal would establish a five percent limit. The Commission believes that the lower amount it is proposing may be more appropriate than the NFA amount because it is closer to the "de minimis" level of commodity interest trading that the rule is intended to encompass, and, further, because the level of investor qualification proposed under the rule – i.e., that of an "accredited investor" – is not a particularly high threshold to meet.<sup>37</sup> Moreover, the rule would provide, through its alternative test, another means for CPOs to come within its exemptive criteria.<sup>38</sup> The Commission also believes that, unlike the NFA Proposal, Rule 4.13(a)(3) should not differentiate between trading for bona fide hedging and non-hedging purposes, because, as stated above, the rule is intended to apply to de minimis situations, where commodity interest trading – regardless of its purpose – is strictly limited. The Commission

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<sup>37</sup> Rule 501(a) under the Securities Act defines a natural person "accredited investor" as:

(5) Any natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase exceeds \$1,000,000; [or]

(6) Any natural person who had an individual income in excess of \$200,000 in each of the two most recent years or joint income with that person's spouse in excess of \$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year.

The chart below illustrates that a significant number of commodity interest contracts could be established under the proposed "Two Percent Test."

<sup>38</sup> The Commission has patterned this alternative test on the temporary registration no-action relief it issued for CPOs and CTAs in the ANPR, which in turn the Commission had based on the Prior Rule 4.5 Proposal.

notes that two commenters on the ANPR suggested that the Commission should not distinguish between hedge and non-hedging positions, claiming that such distinctions between these two types of trading are difficult to administer. However, one commenter specifically suggested that the Commission should distinguish between hedge and non-hedge activity in setting a de minimis standard. Accordingly, the Commission specifically requests comments on whether under the rule there should be: (1) a higher percentage of assets that may be committed to establish commodity interest positions; and (2) any greater ability to trade commodity interests for bona fide hedging purposes than for non-hedging purposes, including whether there should be any restriction whatsoever on trading for hedging purposes. To assist persons in providing such comments, set forth below is a chart with examples of the application of the various tests under the NFA’s and the Commission’s proposals, with “LV” standing for the pool’s liquidation value and “NT” standing for the notional test.

Contracts	LV (\$)	50% LV (\$)	5% LV (\$)	2% LV (\$)	Initial Margin 9/26/02 (\$)	Settlement level 9/25/02	Contract Value (\$)	Contracts 5% Test	Contracts 2% Test	Contracts NT	Contracts 50% LV NT
S&P	10m	5m	500,000	200,000	17,813	819.29	204,822.50	28	11	48	24
T-Note	10m	5m	500,000	200,000	1,755	114,160.00	114,160.00	284	113	87	43

In response to comments, the Commission is clarifying in Proposed Rule 4.13(a)(3)(i) that the pool may at any time meet either of these tests; compliance with the criteria of a test is determined at the time the most recent position is established; the criterion of paragraph (a)(3)(i)(B) applies on a net basis; and the calculation of “notional value” under paragraph (a)(3)(i)(B) now includes the number of futures and options contracts and any multiplier

specified in those contracts.<sup>39</sup> While the Commission believes either criterion is an appropriate limited trading standard, it nonetheless specifically requests comment on the proposed “Two Percent Test.”

As with the NFA Proposal, this new rule would require that each participant in the pool is an “accredited investor” and would require a person claiming relief thereunder to “not market participations in the pool as or in a vehicle for trading in the commodity futures or commodity options markets.” In response to comments on the ANPR, the Commission is further clarifying in Proposed Rule 4.13(a)(3) that a CPO claiming relief thereunder could also operate certain other pools – i.e., the pools meeting the criteria of Rule 4.13(a)(4), discussed below – without voiding the availability of the relief under either rule.<sup>40</sup>

3. Proposed Rule 4.13(a)(4): Adding an exemption where pool participants meet specified sophistication criteria

Proposed Rule 4.13(a)(4) is based on the MFA Proposal. It provides that a person is exempt from CPO registration if interests in the pool for which it seeks to claim relief (1) are exempt from registration under the Securities Act of 1933, and (2) are offered and sold without marketing in the United States (U.S.). In addition, the CPO must reasonably believe that: (1) natural person participants are “qualified eligible persons [QEPs],” as that term is defined in

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<sup>39</sup> The Commission also is making these clarifications in the temporary no-action relief it is maintaining below.

<sup>40</sup> This provision, and the reciprocal provision of Rule 4.13(a)(4), do not include persons and pools meeting the criteria of Rule 4.13(a)(1) or 4.13(a)(2). This is because Rule 4.13(a)(1) is available where, among other things, only one pool is being operated and Rule 4.13(a)(2) would take the operations of such pools into account in computing whether the contribution and participant limitations of the rule had been met.

Rule 4.7(a)(2);<sup>41</sup> and (2) non-natural person participants are QEPs under Rule 4.7 or “accredited investors.” While the MFA Proposal would include any natural person who is a QEP under Rule 4.7, the Commission does not believe that proposed Rule 4.13(a)(4) needs to be so broad in light of both the absence of any trading limitations therein and the other, alternative criteria being proposed in Rule 4.13(a)(3). Thus, the Commission believes that the Rule 4.7(a)(2) standards for natural persons – e.g., persons who are “qualified purchasers” under Section 2(a)(51)(A) of the ICA<sup>42</sup> – may be more appropriate for the rule. The Commission nonetheless specifically requests comment on what investor qualifications would be appropriate under Rule 4.13(a)(4)

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<sup>41</sup> Specifically, natural persons who come within the MFA Proposal but not proposed Rule 4.14(a)(4) include persons who are “accredited investors” and who meet the Portfolio Requirement of Rule 4.7(a)(1)(v), in that they own securities having an aggregate market value of at least \$2,000,000, have futures margin and option premiums on deposit of at least \$200,000, or own a portfolio with a proportionate combination of these two types of assets.

<sup>42</sup> 15 U.S.C. 80a-2(a)(51)(A) (2000), which defines a natural person “qualified purchaser” as:

(i) any natural person (including any person who holds a joint, community property, or other similar shared ownership interest in an issuer that is excepted under section 80a-3(c)(7) of this title with that person's qualified purchaser spouse) who owns not less than \$5,000,000 in investments, as defined by the [SEC];

or

(iv) any person, acting for its own account or the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis, not less than \$25,000,000 in investments.

Rule 2a51-1(b) under the ICA defines “investments” generally to include (when held for investment purposes, as defined in the rule): securities; real estate; commodity interests; physical commodities; and cash and cash equivalents. Pursuant to ICA Rule 2a51-1(e), the amount of outstanding indebtedness incurred to acquire investments must be deducted from the amount of owned and invested investments when determining if the person is a “qualified purchaser.”

and whether all natural person QEPs should be included for purposes of proposed Rule 4.13(a)(4).

Here, too, and in response to the comments received on the ANPR, Rule 4.13(a)(4) would make clear that a CPO claiming relief thereunder could also operate pools meeting the criteria of Rule 4.13(a)(3) without voiding the availability of the relief under either rule.

#### 4. Additional provisions under Rule 4.13

Under the proposed amendments, Rule 4.13 would also contain introductory text and certain additional provisions, which would be based on the provisions of the existing rule, the NFA Proposal, the MFA Proposal and the comments on the ANPR. Generally speaking, these provisions concern: certain disclosures that a CPO who has claimed relief under the rule must make to prospective participants (proposed paragraph (a)(5)); the notice of registration exemption that the CPO would be required to file (proposed paragraph (b));<sup>43</sup> the CPO's obligations with respect to books and records, special calls, annual reports, and monthly statements<sup>44</sup> (proposed paragraph (c)); the CPO's obligations in the event it subsequently applies for registration (proposed paragraph (d));<sup>45</sup> and the effect of registration on a CPO who: (1) is

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<sup>43</sup> In addition to current requirements, the CPO would be required to provide its main facsimile number and main email address.

<sup>44</sup> Consistent with current Rule 4.13, the requirement to furnish monthly statements would be applicable solely to CPOs claiming relief under paragraph (a)(1) or (a)(2) of the rule.

<sup>45</sup> Also consistent with the current provisions of Rule 4.13, the obligation to file an annual report for its pool in the event the CPO subsequently applies for registration would be applicable to CPOs claiming relief under paragraph (a)(1) or (a)(2) of the rule. This obligation would not also be applicable to CPOs claiming relief under paragraph (a)(3) or (a)(4) of the rule, because the pool's annual report would not provide information sufficient to determine whether or not the

eligible for exemption under Rule 4.13 but registers as a CPO nonetheless (proposed paragraph (e)(1)); or (2) operates one or more pools for which it is required to register, and is registered, as a CPO and one or more pools for which it is eligible to claim an exemption from registration under Rule 4.13(a)(3) or 4.13(a)(4) (proposed paragraph (e)(2)).<sup>46</sup>

#### 5. Alternative proposal for relief

As an alternative to the foregoing proposals for certain CPOs, and the following proposals for certain CTAs, the Commission seeks comment on adoption of a notice registration scheme. The notice registration approach would be identical to the proposed exemption approach with respect to information required to be filed with the Commission and compliance with Part 4 requirements. Specifically, the Commission seeks comment on whether a notice registration scheme could make it more clear to the public and other regulatory authorities that this group of CPOs and CTAs remains subject to the CFTC's jurisdiction under the CEA, the Bank Secrecy Act and other statutes, while providing the same amount of regulatory relief as the proposed exemption.

#### C. Proposed Amendments to Rule 4.14: Expanding and Adding CTA Registration

##### Exemptions

1. Proposed Amendments to Rule 4.14(a)(8)
  - a. Exemption for state-registered investment advisers (IAs)

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CPO had been in compliance with the applicable criteria (i.e., trading limitations and/or investor qualifications) throughout the pool's fiscal year.

<sup>46</sup> For the reasons provided above in its discussions of proposed paragraphs (a)(3) and (a)(4), the Commission has not included CPOs eligible for relief under paragraph (a)(1) or (a)(2) in proposed paragraph (e)(2).

Currently, Rule 4.14(a)(8) provides an exemption from CTA registration for certain IAs registered as such, or excluded from such registration, under the Investment Advisers Act of 1940 (IAA)<sup>47</sup> who provide commodity interest trading advice to Rule 4.5 trading vehicles and who meet certain other criteria – e.g., they do not otherwise hold themselves out as a CTA.

When the Commission adopted Rule 4.14(a)(8) in 1987,<sup>48</sup> absent the availability of an exemption, an IA was required to be registered under the IAA to be eligible for the CTA registration exemption provided by the rule. As a result of the National Securities Markets Improvement Act of 1996<sup>49</sup> and SEC rules issued thereunder, IAs may not register with the SEC unless they have \$25 million under management;<sup>50</sup> IAs who do not meet this criterion must register with state regulatory authorities.<sup>51</sup> To update Rule 4.14(a)(8), and in response to Roundtable comments, the Commission is proposing to amend the rule so as to make it equally available to SEC-registered or excluded-from-registration IAs and state-registered IAs (proposed Rule 4.14(a)(8)(i)). Further, to conform the rule with the changes the Commission is proposing to make to Rule 4.5, as are discussed above (e.g., deletion of the existing limitation on non-hedge commodity interest trading), the Commission is proposing to delete from Rule 4.14(a)(8) the

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<sup>47</sup> 15 U.S.C.80b-1 et. seq. (2000).

<sup>48</sup> See 52 FR 41975 (Nov. 2, 1987).

<sup>49</sup> Pub. L. No. 104-290, 110 Stat. 3416 (1996).

<sup>50</sup> SEC Rule 275.203A-1, 17 CFR 275.203A-1 (2002), provides that an IA is not required to register with the SEC unless it has at least \$30 million in assets under management, but may register with the SEC if it has between \$25 million and \$30 million in assets under management.

<sup>51</sup> 17 CFR 275.203A-1 (2002).

current requirement that the IA's commodity interest advice "[e]mploys only such strategies as are consistent with eligibility status under §4.5."

b. Exemption where advice is provided to foreign funds

Also in response to Roundtable comments, and to acknowledge and codify Commission staff's activity in this area,<sup>52</sup> the Commission is proposing relief from CTA registration for those IAs who provide commodity interest trading advice to commodity pools organized and operated outside of the U.S., its territories and possessions that meet certain criteria – for example, only non-U.S. persons may be pool participants, except for the pool's operator, advisor and their principals. (Proposed Rule 4.14(a)(8)(i)(C)(2)).

c. Exemption where advice is provided to Rule 4.13(a)(3) and 4.13(a)(4) pools

Further, and based on the NFA Proposal, the Commission is proposing CTA registration relief for advisors to commodity pools that meet the requirements of the new exemptions being proposed based upon participant sophistication or trading limitations. (Proposed Rule 4.14(a)(8)(i)(D)). In response to the comments on the ANPR, the Commission also has included a proviso in this proposal to make clear that a person may claim relief from CTA registration if it also advises the other trading vehicles specified in the rule – e.g., qualifying entities under Rule 4.5. (Proposed Rule 4.14(a)(8)(i)(A)).

The foregoing relief would remain subject to compliance with the existing criteria of Rule 4.14(a)(8) – i.e., that the person provides commodity interest trading advice solely incidental to its business of providing securities or other investment advice to the trading

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<sup>52</sup> See, e.g., CFTC Staff Letter No. 00-96 (Oct. 4, 2000).

vehicles specified in the rule and that it is not otherwise holding itself out as a CTA. (Proposed Rules 4.14(a)(8)(ii)(A) and (B)).

Several commenters on the registration no-action relief issued through the ANPR noted that, like the NFA Proposal, it only provided relief in the context of pools. They claimed that CTA registration relief should be available with respect to accounts that meet the criteria of Rule 4.14(a)(3) or 4.14(a)(4) – regardless of the form of the account (i.e., collective trading vehicle or individual account). In response, the Commission notes that because of the intermediation of these collective trading vehicles by CPOs to whom the Commission is herein proposing registration relief, it is appropriate to so restrict CTA registration relief. The Commission further notes the expanded availability of the relief from CTA registration in Section 4m(1) of the Act that it is proposing below.

2. Proposed Rule 4.14(a)(10): Counting Legal Organizations as a Single “Person”

Section 4m(1) of the Act provides an exemption from CTA registration for any person:

who, during the course of the preceding twelve months, has not furnished commodity trading advice to more than fifteen persons and who does not hold himself out generally to the public as a commodity trading advisor.

Where the “person” is a legal entity, the CFTC has “looked through” the entity and counted its owners for the purpose of determining whether the “not more than fifteen persons” criterion has been met.

Congress patterned Section 4m(1) after Section 203(b)(3) of the IAA,<sup>53</sup> which provides an exemption from IA registration for any IA:

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<sup>53</sup> 15 U.S.C. 80b-3(b)(3) (2000).

who, during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to [certain trading vehicles].

However, by Rule 203(b)(3) under the IAA,<sup>54</sup> the SEC has permitted IAs to count certain non-natural persons as a single client for the purpose of computing the “fewer than fifteen clients” criterion.

In response to Roundtable comments on this difference in regulatory treatment, the Commission is proposing in new Rule 4.14(a)(10) to provide an exemption from registration for any CTA who meets the criteria of Section 4m(1) of the Act. (Proposed paragraph (a)(10)). For the purpose of this exemption, the CTA may deem certain persons a single person. In making this proposal, the Commission is patterning the single “persons” specified therein on the single “clients” specified in SEC Rule 203(b)(3).

### 3. Additional provisions under Rule 4.14

Under the proposed amendments, Rule 4.14 would also contain introductory text and certain additional provisions, which would be based on the provisions of the current rule, the NFA Proposal and the comments on the ANPR. Generally speaking, these provisions concern: the notice of registration exemption that a CTA seeking exemption under paragraph (a)(8) must file (proposed paragraph (a)(8)(iii));<sup>55</sup> the CTA’s obligations with respect to books and records and special calls (proposed paragraph (a)(8)(iv)); and the effect of registration on a CTA who:

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<sup>54</sup> 17 CFR 275.203(b)(3) (2002).

<sup>55</sup> In addition to current requirements, the CTA would be required to provide its main facsimile number and main email address.

(1) is eligible for exemption under Rule 4.14, but registers as a CTA nonetheless (proposed paragraph (c)(1)); or (2) provides commodity interest trading advice to one or more clients for which it is required to register and one or more clients for which it is eligible to claim an exemption from registration under Rule 4.14(a)(8) (proposed paragraph (c)).

D. Proposed Amendments to Rules 4.21, 4.22 and 4.31

1. Permitting communications prior to Disclosure Document distribution

Commission Rules 4.21 and 4.31 prohibit CPOs and CTAs from soliciting prospective pool participants or clients prior to providing a Disclosure Document. However, the Commission has increasingly received comments, including testimony from Roundtable participants, that Rules 4.21(a) and 4.31(a) unnecessarily restrict communications by CPOs and CTAs. In response, the Commission is proposing to amend these rules to provide that the Disclosure Documents referred to therein must be delivered by no later than the time a CPO delivers a subscription agreement for the pool for which it is soliciting or a CTA delivers an advisory agreement for the trading program for which it is soliciting.<sup>56</sup> To ensure compliance with the purpose of the Disclosure Document – *i.e.*, that prospective investors are fully informed about all material facts before committing their funds,<sup>57</sup> and consistent with the Roundtable comments, these proposed rule amendments would require that “any material distributed in advance of the delivery of the Disclosure Document is consistent with or amended by the

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<sup>56</sup> Because this proposal would obviate the Rule 4.21(a)(2) “profile document” and “term sheet” exceptions to the current Disclosure Document delivery requirement of Rule 4.21(a)(1), the Commission also is proposing to delete these exceptions from the rule.

<sup>57</sup> See, e.g., 44 FR 1918, 1920.

information contained in the Disclosure Document and with the obligations of the [CPO or CTA] under the Act, the Commission’s regulations issued thereunder, and the laws of any other applicable federal or state authority.”<sup>58</sup>

2. Removing duplicative requirements in the “master/feeder fund” context

As explained above, Rule 4.21 requires each person registered (or required to be registered) as a CPO to deliver a Disclosure Document to prospective participants in the commodity pool for which it is soliciting. Rule 4.22 requires the CPO to distribute periodic Account Statements<sup>59</sup> and an Annual Report<sup>60</sup> to the participants in the pool. Where the prospective or actual participant is another commodity pool, the CPO need only deliver a Disclosure Document and distribute periodic Account Statements and an Annual Report to the

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<sup>58</sup> See, e.g., Section 4m(2) of the Act, 7 U.S.C. 6m(2) (2000), which provides in pertinent part that:

Nothing in this Act shall relieve any person of any obligation or duty, or affect the availability of any right or remedy available to the Securities and Exchange Commission or any private party arising under the Securities Act of 1933 or the Securities Exchange Act of 1934 governing the issuance, offer, purchase, or sale of securities of a commodity pool, or of persons engaged in transactions with respect to such securities, or reporting by a commodity pool.

<sup>59</sup> Rule 4.22(a).

<sup>60</sup> Rule 4.22(c).

In addition to the other amendments it is proposing to Rule 4.22, the Commission is proposing to delete from paragraph (c) of the rule the now obsolete requirement that the “first fiscal year for which an Annual Report is due shall be the first fiscal year that begins on or after January 1, 1979.”

pool operator of the other commodity pool; the CPO need not also deliver and distribute this information to each of the participants in the other pool.

Commission staff has provided relief on numerous occasions from the requirements of Rules 4.21 and 4.22 where the CPOs of two pools (i.e., a master fund and a feeder fund) were closely affiliated,<sup>61</sup> a practice supported by Roundtable comments. Accordingly, the Commission is proposing to codify this relief in new Rules 4.21(a)(2), 4.22(a)(4) and 4.22(c)(6). Because Rules 4.7 and 4.12(b) provide relief from certain of the specific requirements of Rules 4.21 and 4.22, these proposed new rules would also include references to materials that must be furnished pursuant to Rule 4.7(b)(1) or 4.12(b)(2)(i), Rule 4.7(b)(2) or 4.12(b)(2)(ii), and Rule 4.7(b)(3) or 4.12(b)(2)(iii), respectively, thereby further reducing the reporting burdens under Rules 4.7 and 4.12.

### 3. Distributing Account Statements electronically

The Commission is also proposing to amend Rule 4.22 to establish the procedures pursuant to which a CPO may distribute periodic Account Statements to pool participants by electronic means, provided the CPO obtains the prior consent of each such participant. This proposal is patterned on the Commission's recent amendments to Rules 1.33 and 1.46,<sup>62</sup> which permit futures commission merchants to deliver monthly statements electronically to their

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<sup>61</sup> See, e.g., CFTC Staff Letter No. 02-102 (Aug. 29, 2002).

<sup>62</sup> See 66 FR 53510 (Oct. 23, 2001).

customers. Moreover, it would codify the Commission’s prior interpretation that permitted, and provided guidance on, electronic distribution of Account Statements.<sup>63</sup>

As proposed, before a CPO could electronically distribute Account Statements to a participant, new paragraph (b)(2) of Rule 4.22 would require the CPO to obtain a signed consent from the participant acknowledging that the CPO had disclosed the following information to it: the participant’s right to receive Account Statements in paper form or electronically; the electronic medium or source through which the CPO will distribute the Account Statements; the duration of the period during which the consent to receive Account Statements electronically will be effective; any charges for electronic distribution; and the participant’s right to revoke consent to electronic distribution at any time. For a participant that is not an “institutional customer,”<sup>64</sup> the CPO would be required to obtain the participant’s signed consent acknowledging the disclosures, prior to the transmission of any Account Statement by means of electronic media. Institutional customers would not need to provide written consent. New paragraph (h)(4) of Rule 4.22 would establish the signature requirements for an Account Statement distributed electronically, by providing that “for each pool for which the CPO distributes an Account Statement by means of electronic media, the CPO must make and keep . . . a manually signed copy” of the oath or affirmation required under Rule 4.22(h).<sup>65</sup>

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<sup>63</sup> See 62 FR 39104, 39110-39111 (July 22, 1997).

<sup>64</sup> Rule 1.3(g) defines “institutional customer” to have the same meaning as “eligible contract participant” as defined in Section 1a(12) of the Act.

<sup>65</sup> See 61 FR 42146, 42158 n.91 (Aug. 14, 1996), after which the Commission has patterned this proposal.

The Commission understands that there may be special concerns surrounding the electronic distribution of Annual Reports that are required to be certified by an independent public accountant and, in particular, surrounding the attachment of the certification itself that the public accountant provides with the report.<sup>66</sup> Accordingly, the Commission is not now proposing any criteria pursuant to which a CPO may distribute the Annual Report electronically but, instead, the Commission is seeking comment on what those criteria should be.

#### 4. Providing facsimile signatures on Account Statements and Annual Reports

In the preamble of the Federal Register release announcing the adoption of the oath or affirmation requirement of Rule 4.22(h), the Commission explained that “a facsimile signature would be appropriate,” provided the CPO maintains the Account Statement or Annual Report containing the manual signature from which the facsimile signature was made, and that an Annual Report that is filed with the Commission contains the manual signature.<sup>67</sup> The Commission is proposing to codify this explanation in new paragraph (h)(4)(i) of Rule 4.22. Inasmuch as the Commission recently has delegated to NFA the review of, among other documents, pool Annual Reports,<sup>68</sup> this provision would refer to the Annual Report that the CPO files with a registered futures association.

#### 5. Conforming signature requirements

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<sup>66</sup> Rule 4.7(b)(3) permits a CPO who has claimed relief under the rule to distribute an Annual Report that is not certified, but that nonetheless must be presented and computed in accordance with generally accepted accounting principles consistently applied.

<sup>67</sup> See 46 FR 26004, 26011 (May 8, 1981).

<sup>68</sup> See 67 FR 77470 (Dec. 18, 2002).

Certain Part 4 rules, including several of the rules being proposed in this Federal Register release, provide that the various documents required thereunder must be signed by CPOs and CTAs. In particular, Rules 4.7(d), 4.12(b), 4.13(b), and 4.22(h) provide that the documents required thereunder must be signed by a CPO or CTA as follows: if it is a sole proprietorship, by the sole proprietor; if a partnership, by a general partner; and if a corporation, by the chief executive officer or chief financial officer.

Upon review of this list of permitted signatories, the Commission believes that it may be unnecessarily restrictive in that it leaves no room for other organizational structures under which CPOs and CTAs operate – e.g., limited liability companies. Accordingly, the Commission is proposing to amend Rules 4.7(d), 4.12(b) and 4.13(b) to provide that the documents required thereunder “must be signed by a duly authorized representative” of the CPO or CTA. This would be consistent with existing signature requirements under Rules 4.5 and 4.14.<sup>69</sup> And, as the Commission stated in connection with the adoption of Rule 4.5, a “duly authorized representative” is “a representative who has been authorized to bind the person on whose behalf [a document is produced] to the information and the representations contained in [the document].”<sup>70</sup> However, because the document required under Rule 4.22(h) pertains to the accuracy and completeness of certain financial reports (i.e., commodity pool Account Statements

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<sup>69</sup> See also, 67 FR 38869 (June 6, 2002), wherein the Commission adopted a similar signatory provision in connection with amendments to its registration rules to facilitate on-line registration.

<sup>70</sup> 50 FR 15868, 15874.

and Annual Reports), the Commission specifically is proposing that this oath or affirmation be signed “by a representative duly authorized to bind the pool operator.”

#### **IV. Temporary No-Action Relief**

By this Federal Register release, the Commission is, with certain modifications and clarifications made in response to comments on both the Prior Rule 4.5 Proposal and the ANPR, confirming the temporary no-action relief it issued in the Prior Rule 4.5 Proposal and the ANPR.<sup>71</sup> Specifically, in addition to providing temporary no-action relief where the pool a CPO operates engages in a limited amount of commodity interest trading, the Commission is clarifying that: at any time, either the limited trading or notional test must be met; compliance with the criterion of a test is determined at the time the most recent position is established; the notional test criterion applies on an aggregate net basis; and the calculation of “notional value” includes the number of futures and options contracts and any multiplier specified in those contracts.

##### A. Temporary No-Action Relief for Rule 4.5 Eligible Persons

The Commission will not commence any enforcement action against an eligible person for failure to register as a CPO in accordance with Section 4m(1) of the Act, where the eligible person operates a qualifying entity such that at any time, with respect to non-hedge positions in commodity futures or commodity option contracts, either of the following tests is met:

- (i) The aggregate initial margin and premiums required to establish such positions, determined at the time the most recent position was established, does not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such

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<sup>71</sup> See 67 FR 65743, 65745 and 67 FR 68785, 68788-89, respectively, and the examples provided therein.

contracts it has entered into; Provided, 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 Rule 190.01(x) may be excluded in computing such five percent; or

(ii) The aggregate net notional value of such positions, determined at the time the most recent position was established, does not exceed the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into. For this purpose, the term "notional value" should be calculated for each such futures position by multiplying the size of the contract, in contract units (taking into account any multiplier specified in the contract), by the current market price per unit and for each such option position by multiplying the size of the contract, in contract units (taking into account any multiplier specified in the contract), by the strike price per unit.

Neither eligible persons who have claimed relief under Rule 4.5 nor eligible persons who claim such relief in the future need to take any additional action to operate their qualifying entities in accordance with the notional test. Rather, making the representations currently required by the rule in a Notice filed with the NFA and the Commission – including the representation concerning the Five Percent Test – is all that is required.

This relief will remain in effect until such time as the Commission takes final action on the amendment to Rule 4.5 it is proposing herein. This relief is, however, subject to the condition that, upon adoption of any amendment to Rule 4.5, the eligible person must comply in full with the terms of any amendment the Commission may adopt. When the Commission adopts a final rule, it will, if necessary, provide affected eligible persons and qualifying entities with sufficient time within which to comply with the rule adopted or to liquidate positions entered into in accordance with the no-action relief.

## B. CPO and CTA Temporary Registration No-Action Relief

### 1. Relief for CPOs

#### a. In General

The Commission will not commence any enforcement action against a CPO for failure to register as a CPO under Section 4m(1) of the Act, where each pool for which the CPO claims registration no-action relief hereunder 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>72</sup> Non-U.S. 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

(ii) At any time, the pool’s commodity interest trading, whether entered into for bona fide hedging purposes or otherwise,<sup>73</sup> meets either of the following tests:

(A) The aggregate initial margin and premiums required to establish commodity interest positions, determined at the time the most recent position was established, does not exceed two 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; Provided, 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 Rule 190.01(x) may be excluded in computing such two percent; or

(B) The aggregate net notional value of the pool's commodity interest positions, determined at the time the most recent position was established, does not exceed fifty percent of

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<sup>72</sup> 17 CFR 270.3c-5 (2002).

<sup>73</sup> See Rule 1.3(z).

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. For this purpose, the term 'notional value' should be calculated for each such futures position by multiplying the number of contracts by the size of the contract, in contract units (taking into account any multiplier specified in the contract), by the current market price per unit and for each such option position by multiplying the number of contracts by the size of the contract, in contract units (taking into account any multiplier specified in the contract), by the strike price per unit.

b. CPOs who operate "Funds-of-Funds"

In a footnote to the ANPR, the Commission addressed the situation where a commodity pool indirectly trades commodity interests as a "fund of funds."<sup>74</sup> As the Commission stated:

The operator of a 'fund of funds' (an Investor Fund) that indirectly trade[s] 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.

The Commission provided the following example of this situation:

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

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<sup>74</sup> See 67 FR at 68788, n. 15.

profits and unrealized losses on positions directly entered into by the Fund.

The Commission went on to state that:

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.

In response to these examples, the Commission received two sets of comments. One set claimed that, under these examples, it appeared that fund-of-funds CPOs wishing to claim the no-action relief could invest only in pools operated by CPOs who had themselves already claimed the no-action relief, to the disadvantage of registered CPOs. The other set of comments claimed that the requirements for “direct knowledge of” and “immediate access to” Investee Funds set unnecessarily high standards. The Commission believes these comments have merit. Accordingly, by this Federal Register release the Commission confirms that: (1) the CPO of a fund-of-funds may claim the registration no-action relief provided herein if the CPO of each of the Investee Funds into which the fund-of-funds invests either has registered with the Commission as a CPO or has claimed the no-action relief with respect to the Investee Fund; and (2) regardless of whether the CPO of the Investee Fund was an unregistered CPO that had claimed the registration no-action relief or a registered CPO, in each case the Investor Fund's

CPO would be entitled to rely upon a representation by the Investee Fund’s CPO that the CPO was operating the Investee Fund in compliance with the requirements of the no-action relief. Additionally, by this Federal Register release, the Commission generally seeks comment on how to treat “funds-of-funds” in the context of CPO registration and Rule 4.13.

## 2. Relief for CTAs

The Commission will not commence enforcement action against a CTA for failure to register as a CTA 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 provided herein and its commodity interest trading advice is directed solely to, and for the sole use of, the pool or pools that it operates,<sup>75</sup> or

b. It is registered as an investment adviser under the Investment Advisers Act of 1940 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:

(A) The person's commodity interest trading advice:

(1) Is directed solely to, and for the sole use of, pools operated by CPOs who are eligible to claim relief from CPO registration under the no-action relief;

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

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<sup>75</sup> This provision is patterned after Rule 4.14(a)(5).

(3) Is consistent with the criteria of the CPO registration no-action relief;<sup>76</sup> and

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

By this Federal Register release, the Commission similarly confirms that, regardless of whether a pool to which the CTA sought to provide commodity interest trading advice was operated by an unregistered CPO that had claimed registration no-action relief or a registered CPO, in each case the CTA would be entitled to rely upon a representation by the CPO that the CPO was operating the pool in compliance with the requirements of the CPO registration no-action relief stated above.

### 3. Claim of Registration No-Action Relief

As stated in the ANPR, this registration no-action relief for CPOs and CTAs 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 Registration No-Action Relief will be effective upon filing, so long as the Claim is materially complete.

Specifically, the Claim of Registration No-Action Relief must:

a. State the name, main business address, and main business telephone number of the CPO or CTA claiming the relief;

b. 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;

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<sup>76</sup> In response to comments received by the Commission, this provision was simplified by replacing the words “Employs only strategies that are” with “Is.”

c. Represent that the CPO and 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;

d. Be signed by a duly authorized representative of the CPO or CTA; and

e. 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.

#### 4. One-Way Disclosure by CPOs and CTAs

##### a. For CPOs:

To comply with the terms of a Claim of Registration 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 at all times either: (a) the aggregate initial margin and premiums required to establish commodity interest positions does not exceed two percent of the liquidation value of the pool's portfolio; or (b) the aggregate net 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. A reasonable opportunity to trade for liquidation only will be provided.

b. For CTAs:

To comply with the terms of a Claim of Registration 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. A reasonable opportunity to trade for liquidation only will be provided.

5. 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 that 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 that apply to all commodity interest market participants, such as the prohibitions on manipulation and the trade reporting requirements.

### C. Other Matters

#### 1. Effect of Final Rulemaking on No-Action Relief

The no-action relief the Commission is announcing today by this Federal Register release will remain in effect until such time as the Commission takes final action on the related rules it is proposing herein. Any final rules that the Commission adopts as a result of this proposed rulemaking will supersede this no-action relief. In the event final rules differ from the requirements of the no-action relief, the Commission will provide affected eligible persons, CPOs and CTAs with sufficient time within which to comply with such requirements, or, in the event an eligible person, CPO or CTA is unable or unwilling to so comply, with sufficient time to register with the Commission (or, if applicable, to withdraw a previously filed Claim of No-Action Relief) and to cease engaging in business as a CPO or CTA. Following the effective date of final rules, no new positions may be entered into in accordance with the no-action relief, but the Commission will, if necessary, provide a reasonable opportunity to liquidate previously-entered positions if a person does not wish to comply with the exemptions provided or register under the Act.

#### 2. Continued Availability of No-Action Relief From Commission Staff

The Commission is aware that there may be persons that do not meet the criteria of the no-action relief under Rule 4.5 for eligible persons or Section 4m(1) of the Act for CPOs and

CTAs but that nonetheless, under their particular facts or circumstances, merit relief. The Commission also is aware that, in the past, its staff has provided no-action relief from the criteria of Rule 4.5 and from the registration requirement of Section 4m(1) of the Act on a case-by-case basis. Consistent with that practice, the Commission directs its staff to continue to issue such relief in appropriate cases.

## **V. Related Matters**

### **A. Regulatory Flexibility Act**

The Regulatory Flexibility Act (RFA)<sup>77</sup> requires that agencies, in proposing rules, consider the impact of those rules on small businesses. The Commission has previously established certain definitions of “small entities” to be used by the Commission in evaluating the impact of its rules on such entities in accordance with the RFA.<sup>78</sup> With respect to CPOs, the Commission has previously determined that a CPO is a small entity if it meets the criteria for exemption from registration under current Rule 4.13(a)(2).<sup>79</sup> Therefore, the requirements of the RFA do not apply to CPOs who do not meet those criteria. With respect to CTAs, the Commission has previously stated that it would evaluate within the context of a particular rule proposal whether all or some affected CTAs would be considered to be small entities and, if so, the economic impact on them of the proposal.<sup>80</sup> The Commission believes that the instant

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<sup>77</sup> 5 U.S.C. 601 et seq.

<sup>78</sup> 47 FR 18618 (April 30, 1982).

<sup>79</sup> Id. at 18619-20.

<sup>80</sup> Id. at 18620.

proposed rules will not place any burdens, whether new or additional, on CPOs and CTAs who would be affected hereunder. This is because the instant proposals, if adopted, would provide registration relief for more CPOs and CTAs and, for CPOs and CTAs who are not eligible for that relief, they would reduce, streamline and simplify existing requirements.

The Commission's definitions of small entities do not address the persons and qualifying entities set forth in Rule 4.5 because, by the very nature of the rule, the operations and activities of such persons and entities generally are regulated by federal and state authorities other than the Commission. Assuming, arguendo, that Rule 4.5 eligible persons or qualifying entities would be small entities for purposes of the RFA, the Commission believes that the proposed amendment to Rule 4.5 would not have a significant economic impact on them because it would permit greater operational flexibility for persons currently claiming relief under the rule, and it would make relief under the rule available to more persons (each of whom would only have to file a notice to be relieved from the requirement to register as a CPO and from the disclosure, reporting and recordkeeping requirements applicable to registered CPOs).

Accordingly, the Chairman, on behalf of the Commission, certifies pursuant to Section 605(b) of the RFA<sup>81</sup> that the proposed rules will not have a significant economic impact on a substantial number of small entities. However, the Commission invites the public to comment on this finding.

#### B. Paperwork Reduction Act

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<sup>81</sup> 5 U.S.C. 605(b).

This proposed rulemaking affects information collection requirements. As required by the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)), the Commission has submitted a copy of this section to the Office of Management and Budget for its review.

### **Collection of Information**

Rules Relating to the Operations and Activities of Commodity Pool Operators and Commodity Trading Advisors and to Monthly Reporting by Futures Commission Merchants, OMB Control Number 3038-0005.

The expected effect of the proposed amended rules will be to reduce the burden previously approved by OMB for this collection of information by 31,025.97 hours because, while it will result in an increase in the number of filings under Rules 4.5, 4.13 and 4.14, it will result in a larger decrease in the information collection requirements under the disclosure, reporting and recordkeeping rules that otherwise would be applicable.

Specifically:

The burden associated with Commission Rule 4.5 is expected to be increased by 25 hours:

Estimated number of respondents: 325.

Annual responses by each respondent: 2.

Estimated average hours per response: .5.

Annual reporting burden: 325 hours.

This annual reporting burden of 325 hours represents an increase of 25 hours as a result of the proposed amendment to Rule 4.5.

The burden associated with Commission Rule 4.13 is expected to be increased by 187.5 hours:

Estimated number of respondents: 600.

Annual responses by each respondent: 1.

Estimated average hours per response: .5.

Annual reporting burden: 300.

This annual reporting burden of 300 hours represents an increase of 187.5 hours as a result of the proposed amendments to Rule 4.13.

The burden associated with Commission Rule 4.14 is expected to be increased by 5 hours:

Estimated number of respondents: 60.

Annual responses by each respondent: 1.

Estimated average hours per response: .5.

Annual reporting burden: 30.

This annual reporting burden of 30 hours represents an increase of 5 hours as a result of the proposed amendments to Rule 4.14.

The burden associated with Commission Rule 4.21 is expected to be decreased by 1540 hours:

Estimated number of respondents: 100.

Annual responses by each respondent: 2.

Estimated average hours per response: 2.8.

Annual reporting burden: 560.

This annual reporting burden of 560 hours represents a decrease of 1,540 hours as a result of the proposed amendments to Rules 4.5, 4.13 and 4.21.

The burden associated with Commission Rule 4.22(a) is expected to be decreased by 7,796.25 hours:

Estimated number of respondents: 100.

Annual responses by each respondent: 9.

Estimated average hours per response: 3.85.

Annual reporting burden: 3,465.

This annual reporting burden of 3,465 hours represents a decrease of 7,796.25 hours as a result of the proposed amendments to Rules 4.5, 4.13 and 4.22.

The burden associated with Commission Rule 4.22(c) is expected to be reduced by 4,050 hours:

Estimated number of respondents: 100.

Annual responses by each respondent: 2.

Estimated average hours per response: 9.

Annual reporting burden: 1,800.

This annual reporting burden of 1,800 hours represents a decrease of 4,050 hours as a result of the proposed amendments to Rules 4.5, 4.13 and 4.22.

The burden associated with Commission Rule 4.23 is expected to be reduced by 11,700 hours:

Estimated number of respondents: 100.

Annual responses by each respondent: 1.

Estimated average hours per response: 52.

Annual reporting burden: 5,200

This annual reporting burden of 5,200 hours represents a decrease of 11,700 hours as a result of the proposed amendments to Rules 4.5, 4.13 and 4.22.

The burden associated with Commission Rule 4.31 is expected to be reduced by 577.22 hours:

Estimated number of respondents: 310.

Annual responses by each respondent: 1.33.

Estimated average hours per response: 1.4.

Annual reporting burden: 577.22.

This annual reporting burden of 577.22 hours represents a decrease of 577.22 hours as a result of the proposed amendments to Rule 4.14.

The burden associated with Commission Rule 4.33 is expected to be reduced by 29,880 hours:

Estimated number of respondents: 310.

Annual responses by each respondent: 1.

Estimated average hours per response: 18.

Annual reporting burden: 5,580.

This annual reporting burden of 5,580 hours represents a decrease of 5,580 hours as a result of the proposed amendments to Rule 4.14.

As stated, these changes will result in an overall reduction of 31,025.97 hours in burden for this collection.

Organizations and individuals desiring to submit comments on the information collection requirements should direct them to the Office of Information and Regulatory Affairs, OMB,

Room 10235 New Executive Office Building, Washington, DC 20503; Attention: Desk Officer for the Commodity Futures Trading Commission.

The Commission considers comments by the public on this proposed collection of information in--

- Evaluating whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have a practical use;
- Evaluating the accuracy of the Commission's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;
- Enhancing the quality, usefulness, and clarity of the information to be collected; and
- Minimizing the burden of collection of information on those who are to respond, including through the use of appropriate automated electronic, mechanical, or other technological collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

OMB is required to make a decision concerning the collection of information contained in these proposed regulations between 30 and 60 days after publication of this document in the Federal Register. Therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. This does not affect the deadline for the public to comment to the Commission on the proposed regulations.

Copies of the information collection submission to OMB are available from the CFTC Clearance Officer, 1155 21st Street N.W., Washington, DC 20581, (202) 418-5160.

### C. Cost-Benefit Analysis

Section 15(a) of the Act requires the Commission to consider the costs and benefits of its action before issuing a new regulation under the Act. By its terms, Section 15(a) does not require the Commission to quantify the costs and benefits of a new regulation or to determine whether the benefits of the proposed regulation outweigh its costs. Rather, Section 15(a) simply requires the Commission to “consider the costs and benefits” of its action.

Section 15(a) further specifies that costs and benefits shall be evaluated in light of five broad areas of market and public concern: Protection of market participants and the public; efficiency, competitiveness, and financial integrity of futures markets; price discovery; sound risk management practices; and other public interest considerations. Accordingly, the Commission could in its discretion give greater weight to any one of the five enumerated areas and could in its discretion determine that, notwithstanding its costs, a particular rule was necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the Act.

The proposed amendments are intended to facilitate increased flexibility and consistency, and to rationalize application of Commission regulations to entities subject to other regulatory frameworks. The Commission is considering the costs and benefits of these rules in light of the specific provisions of Section 15(a) of the Act:

#### 1. Protection of market participants and the public

While certain of the proposed amendments are expected to lessen the burden imposed upon CPOs and CTAs, any exclusion or exemption of persons from regulatory requirements would be based on such factors as financial sophistication of pool participants and advisory

clients or a low level of exposure to commodity interest markets. Accordingly, the proposed amendments should have no effect on the Commission's ability to protect market participants and the public.

2. Efficiency and competition

The proposed amendments are expected to benefit efficiency and competition by removing barriers to participation in the commodity interest markets, resulting in greater liquidity and market efficiency.

3. Financial integrity of futures markets and price discovery

The proposed amendments should have no effect, from the standpoint of imposing costs or creating benefits, on the financial integrity or price discovery function of the commodity futures and options markets.

4. Sound risk management practices

The proposed amendments should increase the available range of risk management alternatives for Rule 4.5 eligible persons, as well as for CTAs and CPOs.

5. Other public interest considerations

The proposed amendments will also take into account certain effects of legislative changes (e.g., in the case of exemption for registered investment advisers) and the passage of time (e.g., revising the contribution limit for the small commodity pool exemption and permitting electronic delivery of pool Account Statements).

After considering these factors, the Commission has determined to propose the amendments discussed above. The Commission invites public comment on its application of the

cost-benefit provision. Commenters also are invited to submit any data that they may have quantifying the costs and benefits of the proposal with their comment letters.

#### **List of Subjects in 17 CFR Part 4**

Commodity Pool operators, Commodity trading advisors, Commodity futures,  
Commodity options

For the reasons presented above, the Commission hereby proposes to amend Chapter I of Title 17 of the Code of Federal Regulations as follows:

#### **PART 4 – COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS**

1. The authority citation for part 4 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6b, 6c, 6(c), 6l, 6m, 6n, 6o, 12a and 23.

2. Rule 4.5 is proposed to be amended by:
  - a. deleting paragraph (c)(2)(i);
  - b. redesignating paragraph (c)(2)(ii) as paragraph (c)(2)(i);
  - c. deleting paragraph (c)(2)(iii); and
  - d. redesignating paragraph (c)(2)(iv) as paragraph (c)(2)(ii).

3. Section 4.7 is proposed to be amended by revising paragraph (d)(1)(vii) to read as follows:

**§4.7 Exemption from certain part 4 requirements for commodity pool operators with respect to offerings to qualified eligible persons and for commodity trading advisors with respect to advising qualified eligible clients.**

\* \* \* \* \*

(d)\* \* \*

(1)\* \* \*

(vii) Be manually signed by a duly authorized representative of the commodity pool operator or commodity trading advisor;

\* \* \* \* \*

4. Section 4.12 is proposed to be amended by revising paragraph (b)(3)(vi) to read as follows:

**§4.12 Exemption from provisions of part 4.**

\* \* \* \* \*

(b)\* \* \*

(3)\* \* \*

(vi) Be manually signed by a duly authorized representative of the pool operator; and

\* \* \* \* \*

5. Section 4.13 is proposed to be amended by:

- a. adding introductory text;
- b. deleting the “or” at the end of paragraph (a)(1)(iv);
- c. revising paragraph (a)(2);
- d. adding new paragraphs (a)(3), (a)(4) and (a)(5);
- e. revising paragraph (b);
- f. redesignating paragraph (c) as paragraph (d) and revising it as so redesignated;
- g. adding a new paragraph (c); and

h. redesignating paragraph (d) as paragraph (e) and revising it as so redesignated, to read as follows:

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

This section is organized as follows: Paragraph (a) specifies the criteria that must be met to qualify for exemption from registration under this section; paragraph (b) governs the notice that must be filed to claim exemption from registration; paragraph (c) sets forth the continuing obligations of a person who has claimed exemption under this section; paragraph (d) specifies information certain persons must provide if they subsequently register; and paragraph (e) specifies the effect of registration on a person who has claimed an exemption from registration under this section or who is eligible to claim an exemption from registration hereunder.

(a)\* \* \*

(1)\* \* \*

(iv) Neither the person nor any other person involved with the pool does any advertising in connection with the pool (for purposes of this section, advertising includes the systematic solicitation of prospective participants by telephone or seminar presentation);

(2)(i) None of the pools operated by it has more than 15 participants at any time; and

(ii) The total gross capital contributions it receives for units of participation in all of the pools it operates or that it intends to operate do not in the aggregate exceed \$400,000.

(iii) For the purpose of determining eligibility for exemption under paragraph (a)(2) of this section, the person may exclude the following participants and their contributions:

(A) The pool's operator, commodity trading advisor, and the principals thereof;

(B) A child, sibling or parent of any of these persons;

(C) The spouse of any person specified in paragraph (a)(2)(iii)(A) or (B) of this section;  
and

(D) Any relative of a person specified in paragraph (a)(2)(iii)(A), (B) or (C) of this section, its spouse or a relative of its spouse, who has the same principal residence as such person;

(3)(i) At any time, each pool for which the operator claims exemption from registration under this paragraph (a)(3) meets either of the following tests with respect to its commodity interest positions, whether entered into for bona fide hedging purposes or otherwise:

(A) The aggregate initial margin and premiums required to establish such positions, determined at the time the most recent position was established, will not exceed two 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; Provided, 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) of this chapter may be excluded in computing such two percent; or

(B) The aggregate net notional value of such positions, determined at the time the most recent position was established, 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. For the purpose of this paragraph, the term "notional value" shall be calculated for each such futures position by multiplying the number of contracts by the size of the contract, in contract units (taking into account any multiplier specified in the contract), by the current market price per unit, and for each such option position by multiplying the number of

contracts by the size of the contract, in contract units (taking into account any multiplier specified in the contract), by the strike price per unit;

(ii) It reasonably believes, at the time of investment (or, in the case of an existing pool, at the time of conversion to a pool meeting the criteria of paragraph (a)(3) of this section), that each person who participates in the pool is an “accredited investor,” as that term is defined in §230.501 of this title; Provided, That nothing in paragraph (a)(3) of this section will prohibit the person from claiming an exemption under this section if it additionally operates one or more pools for which it meets the criteria of paragraph (a)(4) of this section; and

(iii) It does not market participations in the pool as or in a vehicle for trading in the commodity futures or commodity options markets; or

(4) For each pool for which the operator claims exemption from registration under this paragraph (a)(4):

(i) Interests in the pool 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, at the time of investment (or, in the case of an existing pool, at the time of conversion to a pool meeting the criteria of paragraph (a)(4) of this section), that:

(A) Each natural person participant (including the person’s self-directed employee benefit plan, if any), is a “qualified eligible person,” as that term is defined in §4.7(a)(2); and

(B) Each non-natural person participant is a “qualified eligible person,” as that term is defined in §4.7, or an “accredited investor,” as that term is defined in §230.501(a)(1)-(3), (a)(7) and (a)(8) of this title; Provided, That nothing in paragraph (a)(4) of this section will prohibit the

person from claiming an exemption under this section if it additionally operates one or more pools that meet the criteria of paragraph (a)(3) of this section.

(5)(i) Eligibility for exemption under this section is subject to the commodity pool operator furnishing in writing to each prospective participant in the pool:

(A) A statement that the pool operator is exempt from registration with the Commission as a commodity pool operator and that therefore, unlike a registered commodity pool operator, it is not required to deliver a Disclosure Document and a certified annual report to participants in the pool; and

(B) A description of the criteria pursuant to which it qualifies for such exemption from registration.

(ii) The pool operator must make these disclosures by no later than the time it delivers a subscription agreement for the pool to a prospective participant in the pool.

(b)(1) A commodity pool operator who desires to claim the relief from registration provided by this section must file a notice of exemption from commodity pool operator registration with the National Futures Association (ATTN: Director of Compliance). The notice must:

(i) Provide the name, main business address, main business telephone number, main facsimile number and main email address of the pool operator claiming the exemption and the name of the pool for which it is claiming exemption;

(ii) Contain the section number pursuant to which the operator is filing the notice (i.e., §4.13(a)(1), (a)(2), (a)(3), (a)(4), or both (a)(3) and (a)(4)) and represent that the pool will be operated in accordance with the criteria of that paragraph or paragraphs; and

(iii) Be signed by a duly authorized representative of the pool operator.

(2) The commodity pool operator must file the notice by no later than the time it delivers a subscription agreement for the pool to a prospective participant in the pool; Provided, That where the operator is registered with the Commission as a commodity pool operator, it must notify its pool's participants in writing that it intends to withdraw from registration and claim the exemption, and it must provide each such participant with a right to redeem its interest in the pool prior to the operator filing a notice of exemption from registration.

(3) The notice will be effective upon filing, provided the notice is materially complete.

(4) A commodity pool operator who has filed a notice of exemption from registration under this section must, in the event that any of the information contained or representations made in the notice becomes inaccurate or incomplete, file a supplemental notice with the National Futures Association to that effect which, if applicable, includes such amendments as may be necessary to render the notice accurate and complete. This supplemental notice must be filed within 15 business days after the pool operator becomes aware of the occurrence of such event.

(c)(1) Each commodity pool operator who has filed a notice of exemption from registration under this section must:

(i) Make and keep all books and records prepared in connection with its activities as a pool operator for a period of five years from the date of preparation;

(ii) Keep such books and records readily accessible during the first two years of the five-year period. All such books and records must be available for inspection upon the request of any

representative of the Commission, the United States Department of Justice, or any other appropriate regulatory agency; and

(iii) Submit to such special calls as the Commission may make to demonstrate eligibility for and compliance with the applicable criteria for exemption under this section.

(2) In the event the pool operator distributes an annual report to participants in the pool for which it has filed the notice, the annual report must be presented and computed in accordance with generally accepted accounting principles consistently applied and, if certified by an independent public accountant, so certified in accordance with §1.16 of this chapter as applicable.

(3) Each commodity pool operator who has filed a notice of exemption from registration pursuant to paragraph (a)(1) or (a)(2) of this section must:

(i) Promptly furnish to each participant in the pool a copy of each monthly statement for the pool that the pool operator received from a futures commission merchant pursuant to §1.33 of this chapter; and

(ii) Clearly show on such statement, or on an accompanying supplemental statement, the net profit or loss on all commodity interests closed since the date of the previous statement.

(d) Each person who applies for registration as a commodity pool operator subsequent to claiming relief under paragraph (a)(1) or (a)(2) of this section must include with its application the financial statements and other information required by §4.22(c)(1) through (5) for each pool that it has operated as an operator exempt from registration. That information must be presented and computed in accordance with generally accepted accounting principles consistently applied.

If the person is granted registration as a commodity pool operator, it must comply with the provisions of this part with respect to each such pool.

(e)(1) Subject to the provisions of paragraph (e)(2) of this section, if a person who is eligible for exemption from registration as a commodity pool operator under this section nonetheless registers as a commodity pool operator, the person must comply with the provisions of this part with respect to each commodity pool identified on its registration application or supplement thereto.

(2) If a person operates one or more commodity pools described in paragraph (a)(3) or (a)(4) of this section, and one or more commodity pools for which it must be, and is, registered as a commodity pool operator, the person is exempt from the requirements applicable to a registered commodity pool operator with respect to the pool or pools described in paragraph (a)(3) or (a)(4) of this section; Provided, That the person:

(i) Furnishes in writing to each prospective participant in a pool described in paragraphs (a)(2), (a)(3) or (a)(4) of this section that it operates:

(A) A statement that it will operate the pool as if the person was exempt from registration as a commodity pool operator;

(B) A description of the criteria pursuant to which it will so operate the pool; and

(ii) Complies with paragraph (c) of this section.

6. Section 4.14 is proposed to be amended by:

a. adding introductory text;

b. revising paragraph (a)(8);

c. removing the period and adding a semi-colon followed by the word “or” at the end of paragraph (a)(9);

d. adding new paragraph (a)(10); and

e. revising paragraph (c), to read as follows:

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

This section is organized as follows: Paragraph (a) specifies the criteria that must be met to qualify for exemption from registration under this section, including the notice of exemption from registration and continuing obligations of persons who have claimed exemption under paragraph (a)(8) of this section; paragraph (b) concerns “cash market transactions”; and paragraph (c) specifies the effect of registration on a person who has claimed an exemption from registration under this section or who is eligible to claim an exemption from registration hereunder.

(a)\* \* \*

(8) It is registered as an investment adviser under the Investment Advisers Act of 1940 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 the provisions of sections 202(a)(2) and 202(a)(11) of the Investment Advisers Act of 1940,

Provided, That:

(i) The person’s commodity interest trading advice is directed solely to, and for the sole use of, one or more of the following:

(A) “Qualifying entities,” as that term is defined in §4.5(b), for which a notice of eligibility has been filed;

(B) Collective investment vehicles that are excluded from the definition of the term commodity “pool” under §4.5(b); and

(C) Commodity pools that are organized and operated outside of the United States, its territories or possessions, where:

(1) The commodity pool operator of each such pool has not so organized and is not so operating the pool for the purpose of avoiding commodity pool operator registration;

(2) With the exception of the pool’s operator, advisor and their principals, solely “Non-United States persons,” as that term is defined in §4.7(a)(1)(iv), will contribute funds or other capital to, and will own beneficial interests in, the pool;

(3) No person affiliated with the pool conducts any marketing activity for the purpose of, or that could reasonably have the effect of, soliciting participation from other than Non-United States persons; and

(4) No person affiliated with the pool conducts any marketing activity from within the United States, its territories or possessions; and

(D) A commodity pool operator who has claimed an exemption from registration under §4.13(a)(3) or 4.13(a)(4), or, if registered as a commodity pool operator, who may treat each pool it operates that meets the criteria of §4.13(a)(3) or 4.13(a)(4) as if it were not so registered;

(ii) The person:

(A) Provides commodity interest trading advice solely incidental to its business of providing securities or other investment advice to qualifying entities, collective investment vehicles and commodity pools as described in paragraph (a)(8)(i) of this section; and

(B) Is not otherwise holding itself out as a commodity trading advisor.

(iii)(A) A commodity trading advisor who desires to claim the relief from registration provided by this §4.14(a)(8) must file a notice of exemption from commodity trading advisor registration with the National Futures Association (ATTN: Director of Compliance). The notice must:

(1) Provide the name, main business address, main business telephone number, main facsimile number and main email address of the trading advisor claiming the exemption;

(2) Contain the section number pursuant to which the advisor is filing the notice (i.e., §4.14(a)(8)(i) or (a)(8)(ii), or both (a)(8)(i) and (a)(8)(ii)) and represent that it will provide commodity interest advice to its clients in accordance with the criteria of that paragraph or paragraphs; and

(3) Be signed by a duly authorized representative of the trading advisor.

(B) The commodity trading advisor must file the notice by no later than the time it delivers an advisory agreement for the trading program pursuant to which it will offer commodity interest advice to a client; Provided, That where the advisor is registered with the Commission as a commodity trading advisor, it must notify its clients in writing that it intends to withdraw from registration and claim the exemption and must provide each such client with a right to terminate its advisory agreement prior to the advisor filing a notice of exemption from registration.

(C) The notice will be effective upon filing, provided the notice is materially complete.

(D) A commodity trading advisor who has filed a notice of registration exemption under this section must, in the event that any of the information contained or representations made in the notice becomes inaccurate or incomplete, file a supplemental notice with the National

Futures Association to that effect which, if applicable, includes such amendments as may be necessary to render the notice accurate and complete. This supplemental notice must be filed within 15 business days after the trading advisor becomes aware of the occurrence of such event.

(iv) Each commodity trading advisor who has filed a notice of registration exemption under this §4.14 (a)(8) must:

(A)(1) Make and keep all books and records prepared in connection with its activities as a trading advisor, including all books and records demonstrating eligibility for and compliance with the applicable criteria for exemption under this section, for a period of five years from the date of preparation; and

(2) Keep such books and records readily accessible during the first two years of the five-year period. All such books and records must be available for inspection upon the request of any representative of the Commission, the United States Department of Justice, or any other appropriate regulatory agency; and

(B) Submit to such special calls as the Commission may make to demonstrate eligibility for and compliance with the applicable criteria for exemption under this section;

(9)\* \* \*

(ii) Providing commodity trading advice based on, or tailored to, the commodity interest or cash market positions or other circumstances or characteristics of particular clients; or

(10) During the course of the preceding 12 months, it has not furnished commodity trading advice to more than 15 persons and it does not hold itself out generally to the public as a commodity trading advisor.

(i) For the purpose of paragraph (a)(10) of this section, the following are deemed a single person:

(A) A natural person, and:

(1) Any minor child of the natural person;

(2) Any relative, spouse, or relative of the spouse of the natural person who has the same principal residence;

(3) All accounts of which the natural person and/or the persons referred to in paragraph (a)(10)(i)(A) of this section are the only primary beneficiaries; and

(4) All trusts of which the natural person and/or the persons referred to in paragraph (a)(10)(i)(A) of this section are the only primary beneficiaries;

(B)(1) A corporation, general partnership, limited partnership, limited liability company, trust (other than a trust referred to in paragraph (a)(10)(i)(A)(4) of this section), or other legal organization (any of which are referred to hereinafter as a “legal organization”) that receives commodity interest trading advice based on its investment objectives rather than the individual investment objectives of its shareholders, partners, limited partners, members, or beneficiaries (any of which are referred to hereinafter as an “owner”); and

(2) Two or more legal organizations referred to in paragraph (a)(10)(i)(B)(1) of this section that have identical owners.

(ii) Special Rules. For the purpose of paragraph (a)(10) of this section:

(A) An owner must be counted in its own capacity as a person if the commodity trading advisor provides advisory services to the owner separate and apart from the advisory services

provided to the legal organization; Provided, That the determination that an owner is a client will not affect the applicability of paragraph (a)(10) of this section with regard to any other owner;

(B)(1) A general partner of a limited partnership, or other person acting as a commodity trading advisor to the partnership, may count the limited partnership as one person; and

(2) A manager or managing member of a limited liability company, or any other person acting as a commodity trading advisor to the company, may count the limited liability company as one person.

(C) A commodity trading advisor that has its principal office and place of business outside of the United States, its territories or possessions must count only clients that are residents of the United States, its territories and possessions; a commodity trading advisor that has its principal office and place of business in the United States or in any territory or possession thereof must count all clients.

(iii) Holding Out. Any commodity trading advisor relying on paragraph (a)(10) of this section shall not be deemed to be holding itself out generally to the public as a commodity trading advisor, within the meaning of section 4m(1) of the Act, solely because it participates in a non-public offering of interests in a collective investment vehicle under the Securities Act of 1933.

\* \* \* \* \*

(c)(1) Subject to the provisions of paragraph (c)(2) of this section, if a person who is eligible for exemption from registration as a commodity trading advisor under this section nonetheless registers as a commodity trading advisor, the person must comply with the

provisions of this part with respect to those clients for which it could have claimed an exemption from registration hereunder.

(2) If a person provides commodity interest trading advice to a client described in paragraph (a) of this section and to a client for which it must be, and is, registered as a commodity trading advisor, the person is exempt from the requirements applicable to a registered commodity trading advisor with respect to the clients so described; Provided, That the person furnishes in writing to each prospective client described in paragraph (a) of this section a statement that it will provide commodity interest trading advice to the client as if it was exempt from registration as a commodity trading advisor.

7. Section 4.21 is proposed to be amended by revising paragraph (a) to read as follows:

**§4.21 Required delivery of pool Disclosure Document.**

(a)(1) Subject to the provisions of paragraph (a)(2) of this section, each commodity pool operator registered or required to be registered under the Act must deliver or cause to be delivered to a prospective participant in a pool that it operates or intends to operate a Disclosure Document for the pool prepared in accordance with §§4.24 and 4.25 by no later than the time it delivers to the prospective participant a subscription agreement for the pool; Provided, That any material distributed in advance of the delivery of the Disclosure Document is consistent with or amended by the information contained in the Disclosure Document and with the obligations of the commodity pool operator under the Act, the Commission's regulations issued thereunder, and the laws of any other applicable federal or state authority.

(2) For the purpose of the Disclosure Document delivery requirement, including any offering memorandum delivered pursuant to §4.7(b)(1) or 4.12(b)(2)(i), the term “prospective

pool participant” does not include a commodity pool operated by a pool operator that is the same as, or that controls, is controlled by, or is under common control with, the pool operator of the offered pool.

\* \* \* \* \*

8. Section 4.22 is proposed to be amended by:
  - a. revising paragraph (a) introductory text;
  - b. adding new paragraph (a)(4),
  - c. redesignating paragraph (b) as paragraph (b)(1),
  - d. adding a new paragraph (b)(2),
  - e. revising paragraph (c) introductory text,
  - f. adding a new paragraph (c)(6),
  - g. revising paragraph (h)(1),
  - h. revising paragraph (h)(3), and
  - i. adding new paragraph (h)(4), to read as follows:

**§4.22 Reporting to pool participants.**

(a) Except as provided in paragraph (a)(4) of this section, each commodity pool operator registered or required to be registered under the Act must periodically distribute to each participant in each pool that it operates, within 30 calendar days after the last date of the reporting period prescribed in paragraph (b) of this section, an Account Statement, which shall be presented in the form of a Statement of Income (Loss) and a Statement of Changes in Net Asset Value, for the prescribed period. These financial statements must be presented and

computed in accordance with generally accepted accounting principles consistently applied. The Account Statement must be signed in accordance with paragraph (h) of this section.

\* \* \* \* \*

(4) For the purpose of the Account Statement delivery requirement, including any Account Statement distributed pursuant to §4.7(b)(2) or 4.12(b)(2)(ii), the term “participant” does not include a commodity pool operated by a pool operator that is the same as, or that controls, is controlled by, or is under common control with, the pool operator of a pool in which the commodity pool has invested.

(b)(1)\* \* \*

(2)(i) The Account Statement may be distributed to a pool participant by means of electronic media if the participant so consents; Provided, That a commodity pool operator must, prior to the transmission of any Account Statement by means of electronic media, disclose: the right of the participant to receive the Account Statement in paper form or by means of electronic delivery; the electronic media through which the Account Statement will be delivered; the duration, whether indefinite or not, of the period during which consent will be effective; any charges for electronic delivery; and that consent to electronic delivery may be revoked by the participant at any time.

(ii) The pool operator must obtain a signed consent acknowledging disclosure of the information set forth in paragraph (b)(2)(i) of this section prior to the transmission of any Account Statement by electronic media to any participant who does not qualify as an institutional customer under §1.3(g) of this chapter.

(c) Except as provided in paragraph (c)(6) of this section, each commodity pool operator registered or required to be registered under the Act must distribute an Annual Report to each participant in each pool that it operates, and must file two copies of the Report with the Commission, within 90 calendar days after the end on the pool’s fiscal year or the permanent cessation of trading, whichever is earlier, but in no event longer than 90 days after funds are returned to pool participants; Provided, however, That if during any calendar year the commodity pool operator did not operate a commodity pool, the pool operator must so notify the Commission within 30 calendar days after the end of such calendar year. The Annual Report must be signed pursuant to paragraph (h) of this section and must contain the following:

\* \* \* \* \*

(6) For the purpose of the Annual Report distribution requirement, including any annual report distributed pursuant to §4.7(b)(3) or 4.12(b)(2)(iii), the term “participant” does not include a commodity pool operated by a pool operator that is the same as, or that controls, is controlled by, or is under common control with, the pool operator of a pool in which the commodity pool has invested; Provided, That the Annual Report of such investing pool contain financial statements that include such information as the Commission may specify concerning the operations of the pool in which the commodity pool has invested.

\* \* \* \* \*

(h)(1) Each Account Statement and Annual Report, including an account statement or annual report provided pursuant to §4.7(b) or 4.12(b), must contain an oath or affirmation that, to the best of the knowledge and belief of the individual making the oath or affirmation, the information contained in the document is accurate and complete; Provided, however, That it

shall be unlawful for the individual to make such oath or affirmation if the individual knows or should know that any of the information in the document is not accurate and complete.

\* \* \* \* \*

(3) Subject to the provisions of paragraph (h)(4) of this section, the oath or affirmation must be manually signed by a representative duly authorized to bind the pool operator.

(4)(i) An Account Statement or Annual Report may contain a facsimile signature, Provided, That:

(A) The CPO maintains in accordance with §4.23 the Account Statement or Annual Report containing the manual signature from which the facsimile signature was made; and

(B) The Annual Report the CPO files with a registered futures association is manually signed.

(ii) For each pool for which the CPO distributes an Account Statement by means of electronic media, the CPO must make and keep in accordance with §4.23 a manually signed copy of the Statement.

9. Section 4.31 is proposed to be amended by revising paragraph (a) to read as follows:

**§4.31 Required delivery of Disclosure Document to prospective clients.**

(a) Each commodity trading advisor registered or required to be registered under the Act must deliver or cause to be delivered to a prospective client a Disclosure Document containing the information set forth in §§4.34 and 4.35 for the trading program pursuant to which the trading advisor seeks to direct the client's commodity interest account or to direct the client's commodity interest trading by means of a systematic program that recommends specific transactions by no later than the time the trading advisor delivers to the prospective client an

advisory agreement to direct or guide the client's account; Provided, That any material distributed in advance of the delivery of the Disclosure Document is consistent with or amended by the information contained in the Disclosure Document and with the obligations of the commodity trading advisor under the Act, the Commission's regulations issued thereunder, and the laws of any other applicable federal or state authority.

\* \* \* \* \*

Issued in Washington, D.C., on March \_\_\_\_, 2003 by the Commission.

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