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COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 4

RIN 3038-AE76

Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors: Prohibiting Exemptions Under Regulation 4.13 on Behalf of Persons Subject to Certain Statutory Disqualifications

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rules.

SUMMARY: The Commodity Futures Trading Commission (CFTC or Commission) is adopting as final (Final Rule) an amendment to Regulation 4.13, which contains the regulations applicable to commodity pool operators (CPOs) and commodity trading advisors. The Final Rule generally prohibits persons who have, or whose principals have, in their backgrounds any of the statutory disqualifications listed in section 8a(2) of the Commodity Exchange Act (CEA or the Act) from claiming a CPO registration exemption under Regulation 4.13. Specifically, the Final Rule will require any person filing a notice claiming such exemption to represent that, subject to limited exceptions, neither the claimant nor any of its principals has in their backgrounds a CEA section 8a(2) disqualification that would require disclosure, if the claimant sought registration with the Commission.

DATES: *Effective Date:* The effective date for this Final Rule is **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Compliance Date: Compliance with the Final Rule will generally be required through the existing notice filing under Regulation 4.13(b)(1), 17 CFR 4.13(b)(1). Therefore, persons who, as of the Final Rule's effective date, have filed that notice and are currently relying on an exemption from CPO registration under Regulation 4.13 will be required to comply with the Final Rule when those persons next file a notice of exemption for the 2021 filing cycle, *i.e.*, on March 1, 2021. Persons claiming a Regulation 4.13 exemption for the first time on or after the Final Rule's effective date will be required to comply with the Final Rule when the person first files a notice of exemption.

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I. Background

a. Statutory and Regulatory Background

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)[1] established a statutory framework for the regulation of the swaps market to reduce risk, increase transparency, and promote market integrity within the financial system. As amended by the Dodd-Frank Act, section 1a(11) of the CEA defines the term "commodity pool operator," as any person[2] engaged in a business that is of the nature of a commodity pool, investment trust, syndicate, or similar form of enterprise, and who, with respect to that commodity pool, solicits, accepts, or receives from others,

[1] Pub. L. 111-203, 124 Stat. 1376 (2010), *available at https://www.govinfo.gov/content/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf* (last retrieved Apr. 20, 2020).
[2] Regulation 1.3 defines "person" as including individuals, associations, partnerships, corporations, and trusts. 17 CFR 1.3. The Commission's regulations are found at 17 CFR Ch. I (2020).

funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in commodity interests.[3] CEA section 4m(1) generally requires each person who satisfies the CPO definition to register as such with the Commission.[4] Additionally, CEA section 8a generally authorizes the Commission to register intermediaries and their associated persons, including CPOs, and also to refuse, condition, or revoke such registration.[5]

CEA section 8a(2) lists the offenses for which the Commission may upon notice, but without a hearing and pursuant to such rules, regulations or orders as the Commission may adopt, refuse to register, to register conditionally, or to suspend or place restrictions upon the registration of, any person, and for which the Commission may revoke the registration of any person with such a hearing as may be appropriate.[6] Commission regulations require all persons applying for registration with the Commission to complete Form 7-R.[7] Each natural person principal of an applicant is also required to complete Form 8-R, to submit fingerprints, and to undergo a criminal background check.[8] One of the purposes of Forms 7-R and 8-R, as well as the fingerprinting requirement, is to determine whether any applicant for registration or any of its principals has in its background one of the enumerated statutory disqualifications in the CEA.[9] If a statutory

[3] 7 U.S.C. 1a(11). The CEA is found at 7 U.S.C. 1, *et seq.* (2018). Both the Act and the Commission's regulations are accessible through the Commission's website, *https://www.cftc.gov*.
[4] 7 U.S.C. 6m(1).
[5] 7 U.S.C. 12a.
[6] 7 U.S.C. 12a(2). Such decisions to refuse, condition, revoke, or place restrictions on registration are subject to appeal by the affected person or registration in the manner provided in section 6(c) of the CEA. *Id.*
[7] *See* 17 CFR 3.10(a)(1)(i).
[8] 17 CFR 3.10(a)(2).
[9] *See* Adoption of Revised Registration Form 8-R, 82 FR 19665, 19665 (Apr. 28, 2017) (describing Form 8-R as designed to "assess the applicant's fitness to engage in business as a derivatives professional"). *See also* Firm Application (Form 7-R), pp. 12-16 (making various inquiries as to the criminal and disciplinary background of the firm and its principals), and p. 22 (requiring the applicant to certify that it would not be

disqualification enumerated in CEA section 8a(2) is disclosed or otherwise revealed through that process, such applicant is generally refused registration on that basis, and such statutorily disqualified principals will generally not be listed with the Commission. The Commission also has the authority under CEA section 8a(5) to make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate the provisions or to accomplish any of the purposes of the CEA.[10] Finally, CEA section 4(c) provides that the Commission, to promote responsible economic or financial innovation and fair competition, by rule, regulation, or order, after notice and opportunity for hearing, may exempt, among other things, any person or class of persons offering, entering into, rendering advice or rendering other services with respect to commodity interests, from any provision of the CEA.[11] CEA section 4(c) provides a statutory basis for the Commission's promulgation of the various regulatory exemptions available to CPOs.

Part 4 of the Commission's regulations governs, among other things, the operations and activities of CPOs.[12] Those regulations implement the statutory authority provided to the Commission by the CEA and establish multiple registration exemptions and definitional exclusions for CPOs, as discussed above.[13] Part 4 also contains regulations that establish the ongoing compliance obligations applicable to CPOs, whether registered or exempt, as well as to those persons operating in the commodity

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statutorily disqualified from registration under section 8a(2) or section 8a(3) of the Act), *available at https://www.nfa.futures.org/registration-membership/templates-and-forms/Form7-R-entire.pdf* (last retrieved June 1, 2020).

[10] 7 U.S.C. 12a(5).

[11] 7 U.S.C. 4(c)(1).

[12] *See* 17 CFR pt. 4, generally.

[13] *See, e.g.*, 17 CFR 4.13 (providing multiple registration exemptions to qualifying persons meeting the CPO definition).

interest markets pursuant to an exclusion from that definition. These requirements pertain to the commodity pools that CPOs operate and advise, and among other things, dictate matters of customer protection, disclosure, and reporting to a CPO's commodity pool participants.

The Commission has previously promulgated, pursuant to these statutory authorities, the various exemptions from registration as a CPO that are enumerated in Regulation 4.13,[14] and the Commission is today utilizing them to revise the basic eligibility criteria and amend the notice filing required to claim certain exemptions set forth in that regulation.[15] As discussed above, persons seeking registration with the Commission, and their principals, are generally refused registration with the Commission on the basis that they have disclosed or are found to have in their backgrounds one of the statutory disqualifications enumerated in CEA section 8a(2). Conversely, prior to this Final Rule, persons claiming an exemption from CPO registration under Regulation 4.13 were not required to disclose any previous matters that might impact their eligibility or fitness for registration, or to otherwise meet any basic conduct standards beyond the substantive conditions of their claimed exemption. The Final Rule amendment seeks to close that regulatory gap by effectively prohibiting any person who has, or whose principals have, in their backgrounds a statutory disqualification listed in CEA section 8a(2) (Covered Statutory Disqualification, or CSD) from claiming a CPO exemption under Regulation 4.13. As a result of the Final Rule, persons who have a CSD in their

[14] *See* 17 CFR pt. 4 (citing as statutory authority, 7 U.S.C. 1a, 2, 6(c), 6b, 6c, 6*l*, 6m, 6n, 6*o*, 12a, and 23).
[15] The Commission notes that the title of the Final Rule, "Amendments to Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors," is consistent with the related notice of proposed rulemaking published in 2018, notwithstanding that the amendment adopted by the Final Rule does not have any effect on commodity trading advisors.

background will generally be foreclosed from acting as a CPO, whether in a registered or exempt capacity, subject to limited exceptions discussed further below.

b. The Commission's October 2018 Proposal, Request for Public Comment, and Recent Final Rules

In response to information received from members of the public, as well as CFTC staff's own internal review of its regulatory regime, the Commission published for public comment in the *Federal Register* on October 18, 2018, a Notice of Proposed Rulemaking (NPRM, or the Proposal), proposing to adopt several regulatory amendments applicable to CPOs and commodity trading advisors.[16] Commission staff had previously become aware of a number of statutorily disqualified CPOs operating commodity pools pursuant to the registration exemption formerly available in Regulation 4.13(a)(4), which the Commission rescinded in 2012.[17] Since the passage of the Dodd-Frank Act, the Commission has proposed and adopted amendments to Regulation 4.13, which have, in general, been designed to identify, accurately and in a timely manner, the exempt CPOs operating in its markets, to incorporate additional registration exemptions where appropriate, and to facilitate customer protection by requiring annual notice filings. The Commission is adopting this Final Rule because it believes that requiring persons to attest to both their and their principals' lack of Covered Statutory Disqualifications through an additional representation in the notice filing required by Regulation 4.13(b)(1) will

[16] Several of the proposed amendments were consistent with, or expansions of, relief that had been previously available through a staff advisory or through no-action and exemptive letters issued over the years by staff of the Commission's Division of Swap Dealer and Intermediary Oversight (DSIO) and its predecessors. See Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors, 83 FR 52902 (Oct. 18, 2018) (Proposal).

[17] After the rescission, such CPOs would have been required to modify their operations to comply with a different exemption under Regulation 4.13, cease their operations, or receive relief from the Commission permitting them to register and continue operating.

further enhance the customer protection of exempt pool participants, and more generally, promote the public interest.

In the NPRM, the Commission included a proposed amendment to Regulation 4.13 that would have required any person claiming an exemption from CPO registration under Regulations 4.13(a)(1)-(a)(5) to represent that neither the person nor any of its principals is subject to any statutory disqualification under section 8a(2) or 8a(3) of the Act, unless such disqualification arises from a matter which was previously disclosed in connection with a previous application, if such registration was granted, or which was disclosed more than thirty days prior to the claim of this exemption (Proposed Regulation 4.13(a)(6)).[18] The Commission noted its belief then that "it poses an undue risk from a customer protection standpoint for its regulations in their current form to permit statutorily disqualified persons or entities to legally operate exempt commodity pools, especially when those same persons would not be permitted to register with the Commission."[19] Additionally, the Commission solicited comment on that particular proposed amendment, raising several specific questions for the public's consideration.[20] In December 2019, the Commission published final amendments (2019 Final Rules) adopting several aspects of the Proposal with the general intent of simplifying the regulatory landscape for CPOs without reducing the customer protection and other benefits provided by those regulations.[21] In describing the scope of the 2019 Final Rules,

[18] Proposal, 83 FR at 52906-07; *see also* Proposal, 83 FR at 52927 (proposing to adopt the prohibition at paragraph (a)(6) of Regulation 4.13).
[19] Proposal, 83 FR at 52906.
[20] Proposal, 83 FR at 52916 (raising questions regarding the scope of the proposed prohibition and its potential impact on currently exempt CPOs, among several other issues).
[21] Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors: Registered Investment Companies, Business Development Companies, and Definition of Reporting Person, 84 FR 67343 (Dec. 10, 2019); *and* Registration and Compliance Requirements for

the Commission stated that certain aspects of the Proposal, including Proposed Regulation 4.13(a)(6), elicited a significant number of responsive and detailed public comments, and as a result, the Commission found that those proposed amendments required further consideration before they could be finalized.[22]

After additional consideration of Proposed Regulation 4.13(a)(6), as well as the ideas, questions, and suggestions received in public comments, the Commission has determined it appropriate to adopt, with specific modifications from the Proposal, the amendment, such that, subject to limited exceptions, persons subject to the Covered Statutory Disqualifications (*i.e.*, those listed in CEA section 8a(2)) will generally no longer be able to claim CPO exemptions under Regulation 4.13, absent a separate determination by the Commission (or its staff, pursuant to delegated authority) under CEA section 8a(2) or Regulation 4.12(a), as more fully described below. The following sections describe the amendment as presented in the Proposal, respond to the substantive comments received, and finally, explain the amendment in its final form and how the Commission intends it to apply in the future.

II. Final Rules

a. Proposed Regulation 4.13(a)(6): A Proposal to Prohibit Statutory Disqualifications in CPOs Claiming Exemption Under Regulation 4.13

In the Proposal, the Commission, for the first time, proposed that CPOs exempt under Regulation 4.13, and principals of the foregoing, who have statutory disqualifications in their backgrounds be subject to conduct standards similar to those of

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Commodity Pool Operators (CPOs) and Commodity Trading Advisors: Family Offices and Exempt CPOs, 84 FR 67355 (Dec. 10, 2019) (2019 Final Rules).

[22] 2019 Final Rules, 84 FR at 67357.

their registered counterparts. The Commission has now determined to exercise its statutory authority to amend the Commission's CPO exemption regime, such that both registered and exempt CPOs will be required to represent that they and their respective principals are not subject to the Covered Statutory Disqualifications listed in the CEA. The Commission continues to believe that "preserving the prohibition on statutory disqualifications… and applying it to exemptions under § 4.13 would provide a substantial customer protection benefit by prohibiting statutorily disqualified persons from operating and soliciting participants for investment in exempt commodity pools."[23]

Proposed Regulation 4.13(a)(6) would have required any person who desires to claim an exemption under paragraphs (a)(1), (a)(2), (a)(3), (a)(4), or (a)(5) of the section to represent that neither the person nor any of its principals is subject to any statutory disqualification under section 8a(2) or 8a(3) of the Act, unless such disqualification arises from a matter which was previously disclosed in connection with a previous application, if such registration was granted, or which was disclosed more than thirty days prior to the claim of this exemption.[24] The Commission did not propose to require that representation from CPOs of Family Offices, which it concurrently proposed to exempt from CPO registration, because "such CPOs would be prohibited from soliciting non-family members/clients to participate in their pool(s), necessarily limiting their contact with prospective participants drawn from the general public, and as a result, reducing the

[23] Proposal, 83 FR at 52916.

[24] Proposal, 83 FR at 52927. This language is nearly identical to the representation required by paragraph C.4. of Staff Advisory 18-96. *See* Offshore Commodity Pools Relief for Certain Registered CPOs From Rules 4.21, 4.22, and 4.23(a)(10) and (a)(11) and From the Location of Books and Records Requirement of Rule 4.23, *available at https://www.cftc.gov/sites/default/files/tm/advisory18-96.htm* (last visited Apr. 22, 2020).

Commission's customer protection concerns in that context."[25] The Commission stated its preliminary belief that this proposed approach "addresses customer protection concerns regarding statutory disqualifications, while preserving flexibility in Commission regulations applicable to CPOs."[26]

The Commission further explained that Proposed Regulation 4.13(a)(6) would "provide additional customer protection because statutorily disqualified, unregisterable persons would no longer be able to claim the CPO exemptions under §[§] 4.13 (a)(1) through (a)(5)."[27] With respect to its future application, the Commission stated its intent that CPOs currently claiming an exemption under Regulation 4.13 would comply, "as they renew their claims on an annual basis – *i.e.*, existing claimants would be required to represent that neither they nor their principals are subject to statutory disqualifications under CEA sections 8a(2) or 8a(3), when they annually affirm their continued reliance on a § 4.13 exemption next year."[28] In contrast, "CPOs filing new claims of a § 4.13 exemption, however, would be required to comply with this prohibition upon filing, if and when the amendments are adopted as proposed, and become effective."[29]

The Commission requested comment generally on all aspects of the Proposal, and also solicited comment through targeted questions about each of the proposed amendments, including Proposed Regulation 4.13(a)(6).[30] In particular, the Commission requested comment on "the impact of adopting this provision on industry participants and currently exempt CPOs, and also, on what, if any, other statutory disqualifications should

[25] Proposal, 83 FR at 52906. The Commission formally adopted a CPO exemption for qualifying Family Offices in the 2019 Final Rules. *See* 2019 Final Rules, 84 FR at 67358, 67368.
[26] Proposal, 83 FR at 52906.
[27] Proposal, 83 FR at 52914.
[28] Proposal, 83 FR at 52907.
[29] Proposal, 83 FR at 52907.
[30] Proposal, 83 FR at 52916.

be permissible for exempt CPOs and their principals."[31] The Commission also asked the following questions:

1) What are the concerns and benefits associated with the expansion of the prohibition on statutory disqualifications to the CPO registration exemptions set forth in §[§] 4.13(a)(1), (a)(2), (a)(3), and (a)(5), or proposed to be set forth in § 4.13(a)(4)?

2) Do the limited exceptions that would permit certain statutory disqualifications successfully address any unintended consequences of adding the prohibition to § 4.13, while still providing a base level of customer protection by preventing statutorily disqualified individuals from legally operating exempt commodity pools?

3) Generally, how should the Commission handle the implementation of the statutory disqualification prohibition?

4) Specifically, how should the prohibition apply to current claimants under § 4.13? How much time should the Commission allow for filing updated exemption claims subject to the prohibition?

5) How much time should the Commission allow for an exempt CPO to replace statutorily disqualified principals, in order to maintain eligibility for a § 4.13 exemption?[32]

The discussion below outlines the public comments received in response to the Proposal, focusing on the substantive comments received regarding Proposed Regulation 4.13(a)(6). The Commission will also explain how it has taken those comments into

[31] Proposal, 83 FR at 52916.
[32] Proposal, 83 FR at 52916.

consideration, via specific adjustments to the Commission's approach in adopting the new statutory disqualification representation as a condition of receiving exemptive relief under Regulation 4.13.

b. General Comments

The Commission received 28 individual comment letters responsive to the NPRM: six from legal and market professional groups; 13 from law firms; seven from individual family offices; one from a government-sponsored enterprise (GSE) actively involved in the housing industry; and one from the National Futures Association (NFA), a registered futures association,[33] who through delegation by the Commission, assists Commission staff in administering its CPO regulatory program.[34] Additionally, Commission staff participated in multiple *ex parte* meetings concerning the Proposal.[35] Seven of the comment letters provided comment specifically on Proposed Regulation 4.13(a)(6).

[33] *See* 7 U.S.C. 21.

[34] Comments were submitted by the following entities: Alscott, Inc.* (Dec. 7, 2018); Alternative Investment Management Association (AIMA) (Letter 1: Dec. 17, 2018, and Letter 2: Oct. 7, 2019); Buchanan, Ingersoll, and Rooney, PC* (Dec. 12, 2018); Commodore Management Company* (Dec. 12, 2018); Dechert, LLP (Dechert) (Dec. 17, 2018); Freddie Mac (Dec. 17, 2018); Fried, Frank, Harris, Shriver, & Jacobson, LLP (Fried Frank) (Dec. 17, 2018); Investment Adviser Association (IAA) (Dec. 17, 2018); Kramer, Levin, Naftalis, & Frankel, LLP* (Dec. 17, 2018); LBCW Investments* (Dec. 5, 2018); Managed Funds Association (MFA) (Dec. 14, 2018); Marshall Street Capital* (Dec. 13, 2018); McDermott, Will, & Emery, LLP* (Dec. 17, 2018); McLaughlin & Stern, LLP* (Dec. 5, 2018); Moreland Management Company* (Dec. 13, 2018); Morgan, Lewis, & Bockius, LLP* (Dec. 18, 2018); NFA (Dec. 17, 2018); New York City Bar Association, the Committee on Futures and Derivatives (NYC Bar Derivatives Committee) (Jan. 4, 2019); Norton, Rose, Fulbright US, LLP* (Dec. 17, 2018); Perkins Coie, LLP* (Dec. 17, 2018); the Private Investor Coalition, Inc. (PIC) (Nov. 28, 2018); Ridama Capital * (Dec. 13, 2018); Schiff Hardin, LLP (two offices)* (Dec. 13 and 17, 2018); the Securities Industry and Financial Management Association Asset Management Group (SIFMA AMG) (Letter 1: Dec. 17, 2018, and Letter 2: Sept. 13, 2019); Vorpal, LLC* (Dec. 17, 2018); Willkie, Farr, and Gallagher, LLP (Willkie) (Dec. 11, 2018); and Wilmer Hale, LLP (Wilmer Hale) (Dec. 7, 2018). Those entities marked with an "*" submitted substantively identical, brief comments, specifically supporting the detailed comments and suggested edits submitted to the Commission by PIC.

[35] *See* "Comments for Proposed Rule 83 FR 52902," *available at https://comments.cftc.gov/PublicComments/CommentList.aspx?id=2925* (last retrieved May 4, 2020).

Commenters generally understood the customer protection goals of the Commission, and many supported the amendment; other commenters opposed it and raised several questions regarding its implementation. Dechert, for instance, opposed Proposed Regulation 4.13(a)(6), stating that the Commission should not extend to exempt CPOs a prohibition generally applicable only to registered CPOs.[36] Dechert further commented that the proposed amendment would impose one of the most costly aspects of registration, that of principal classification and screening, on CPOs that are intended to be exempt from registration.[37] SIFMA AMG additionally opposed Proposed Regulation 4.13(a)(6) and expressed the need for the Commission's consumer protection goals to be balanced appropriately with compliance burdens and costs.[38]

Commenters also compared the process surrounding Proposed Regulation 4.13(a)(6) to the Commission's registration processes currently outlined in part 3 of its regulations. Dechert and other commenters requested more detail on how the proposed amendment would operate and how exceptions would be considered or accepted.[39] Although the majority of comments indicated that their submitters understood the Commission's intention in proposing the prohibition on statutory disqualifications, Dechert expressed confusion as to whether Proposed Regulation 4.13(a)(6) was intended

[36] Dechert, at 7 (arguing that the Commission has generally determined it does not need to apply as close regulatory oversight to exempt CPOs as it does for registered CPOs, and that it is inconsistent with that conclusion for the Commission to apply this prohibition to exempt CPOs).
[37] Dechert, at 7-8. Dechert emphasized the difficulty in determining who is and is not a principal of a CPO, pointing out that some types of principal do not involve a "bright line test," but rather a "facts-and-circumstances analysis." *Id.*
[38] SIFMA AMG, at 17. SIFMA AMG also requested that the Commission consider performing a study to determine if the prohibition against statutory disqualifications was actually needed in the population of exempt CPOs. *Id.*
[39] Dechert, at 11-12; *see also* IAA, at 11, and AIMA, at 9-10.

to require disclosure of such disqualifications, or whether it was actually designed to bar disqualified CPOs from relying on an exemption entirely.[40]

Some commenters cited a lack of clarity on process and other significant uncertainties associated with the proposed amendment, and a couple of commenters requested that the Commission reconsider and/or re-propose it.[41] Alternatively, Dechert requested that the Commission develop processes regarding: (a) the identification and screening of principals; (b) disputing a determination by CFTC or NFA to bar a person from claiming exemption under Regulation 4.13; (c) the "disclosure exception;" and (d) the winding down of operations for affected CPOs in a manner that minimizes market disruption and any disadvantages to pool participants.[42] MFA shared this concern, requesting clarity on the timing of disclosure for CPOs already exempt under a Regulation 4.13 exemption and pointing out the lack of procedure specified in the Proposal.[43] MFA further suggested that the Commission consider adopting regulations that would establish a clear process for currently exempt CPOs to update their disclosures of statutory disqualifications to the Commission or NFA, including the disclosure of violations of requirements of other regulators.[44]

Several commenters were concerned about the scope of Proposed Regulation 4.13(a)(6), including that offenses enumerated in CEA section 8a(3) would be considered statutory disqualifications.[45] AIMA, for instance, explained that the disqualifications

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[40] Dechert, at 9.
[41] Dechert, at 12; SIFMA AMG, at 17.
[42] Dechert, at 11. IAA also requested that the Commission develop a hearing process for denying persons the CPO exemptions, based on a statutory prohibition. IAA, at 11. *See also* AIMA, at 9.
[43] MFA, at 4.
[44] MFA, at 4.
[45] *See, e.g.*, Dechert, at 8 (stating that the statutory disqualifications impacting a person's eligibility for exemption are very broad).

listed under that statutory paragraph, in particular, provide the Commission grounds only for potentially disallowing registration, rather than an automatic bar to registration.[46] Consequently, AIMA requested that any required representation include only offenses under CEA section 8a(2), or that the Commission exclude from consideration offenses listed in CEA section 8a(3)(B) and generally limit the incorporation of offenses in CEA section 8a(3) to those that are no more than ten years old.[47] MFA similarly pointed out that even recordkeeping violations would need to be disclosed pursuant to CEA section 8a(3)(A); MFA also questioned the breadth and meaning of CEA section 8a(3)(M) disqualifications, known only in the statute as "other good cause."[48]

Like AIMA, IAA and SIFMA AMG similarly requested that the representation cover only offenses listed under CEA section 8a(2).[49] SIFMA AMG additionally requested clarification from the Commission that a person would not be "statutorily disqualified" pursuant to a violation under CEA section 8a(3), unless and until the person receives a hearing and the Commission has made the filing with respect to the conduct at issue required by that statutory provision.[50] Dechert requested that the Commission further limit the scope of Proposed Regulation 4.13(a)(6), such that the provision would only effectively prohibit statutory disqualifications involving instances of fraud and similar offenses involving commodities, securities, and other financial instruments, like

[46] AIMA, at 10.
[47] AIMA, at 10.
[48] MFA, at 4. *See also* SIFMA AMG, at 19 (arguing that offenses under CEA section 8a(3) are much less serious, more remote in time, or may be difficult to verify at the time a claim for exemption is filed); AIMA, at 10 (stating that including CEA section 8a(3) would be too broad, as it lists as disqualifying: misdemeanor offenses regardless of age, regulatory offenses routinely cleared by NFA in administering the Commission's registration process for CPOs, and the "amorphous 'other good cause'").
[49] IAA, at 11; SIFMA AMG, at 19.
[50] SIFMA AMG, at 20.

CEA section 8a(2)(D).[51] Additionally, Dechert requested that the Commission also consider: (a) applying Proposed Regulation 4.13(a)(6) to only the person itself claiming the CPO exemption, rather than both the claimant and principals, and (b) grandfathering exempt CPOs currently in existence, in conjunction with the proposed amendment's adoption.[52]

IAA also requested that the Commission not require compliance with the proposed amendment from registered investment advisers (RIAs) because those entities are already subject to the statutory disqualification regime under the Investment Advisers Act of 1940 (IA Act), which, the IAA argued, Proposed Regulation 4.13(a)(6) would duplicate.[53] SIFMA AMG also supported a carve-out for RIAs, explaining that RIAs are subject to a robust statutory disqualification regime under the IA Act, are required to disclose disciplinary events on their Forms ADV, and are also subject to fiduciary duties to their clients.[54]

NFA generally supported Proposed Regulation 4.13(a)(6) and agreed with the Commission's underlying rationale.[55] NFA provided comments specifically regarding the two exceptions the Commission proposed: (a) if the statutory disqualification was previously disclosed in relation to a registration application, which was later granted, or

[51] Dechert, at 11 (stating that, as the prohibition was proposed, any violations of the CEA "could require disclosure of a Statutory Disqualification" and may prohibit a person from claiming a CPO exemption in Regulation 4.13).
[52] Dechert, at 11.
[53] IAA, at 10.
[54] SIFMA AMG, at 18. SIFMA AMG stated that accepting the SEC's statutory disqualification and disclosure regime for RIAs as substituted compliance for purposes of relying on the CPO exemptions under Regulation 4.13 would eliminate unnecessary costs without sacrificing the Commission's customer protection goals, and would also count as harmonization of SEC and CFTC regulations. *Id.*
[55] NFA, at 2.

(b) if the statutory disqualification was disclosed within the previous 30 days.[56] NFA stated that the exception for disqualifications disclosed within 30 days would not be practical, and was further inappropriate to apply to CPOs exempt from registration under Regulation 4.13, because such persons, in contrast to registered CPOs, generally have no ongoing obligation to update Commission registration forms if they should become inaccurate.[57] Thus, NFA stated, there is no mechanism requiring this population of exempt CPOs to update the Commission or NFA as to new or recent statutory disqualifications to which they or their principals may be subject.[58] As a result, NFA suggested that the Commission either abandon this exception entirely, or limit its application to persons that are already registered with the Commission and extend the amount of time.[59] SIFMA AMG likewise raised questions about how currently exempt CPOs that are not registered with the Commission would update the Commission or NFA as to new statutory disqualifications, suggesting that the Commission accept updates by RIAs to their Forms ADV as substituted compliance for such disclosures.[60]

Still other commenters expressed concern over the timing of compliance with Proposed Regulation 4.13(a)(6). AIMA requested that the Commission allow at least 12 months for persons with such statutory disqualifications to come into compliance, so that the issue of whether those disqualifications should be a bar to claiming a CPO

[56] NFA, at 2 (stating that the source of the second exception stems from the ongoing obligation of registered CPOs claiming Staff Advisory 18-96 and/or exemptive relief under Regulation 4.7 to update their registration forms whenever something occurs to make them inaccurate, like the recent commission of a statutory disqualification by the registrant or one of its principals).
[57] NFA, at 2.
[58] NFA, at 2.
[59] NFA, at 3 (explaining that 30 days is simply not enough time to evaluate new statutory disqualifications and/or determine if a registration action or ineligibility determination for exemption is necessary as a result, but failing to specify an alternative amount of time that would be sufficient).
[60] SIFMA AMG, at 19-20.

registration exemption could be determined.[61] Similarly, Willkie requested that the Commission provide sufficient time for industry to absorb a significant rule change like this one, suggested that the effectiveness of the provision coincide with the annual update filings typically due in the first quarter of each year, and requested further that the Commission generally clarify the process around the proposed prohibition.[62] IAA also requested that the Commission delay compliance with the proposed prohibition to allow CPOs to adjust their operations, in case of disqualified principals in their entities.[63]

c. The Final Rule: New Regulation 4.13(b)(1)(iii) and Responses to Specific Comments

After carefully considering Proposed Regulation 4.13(a)(6) as well as all of the public comments received, the Commission has determined it to be an appropriate exercise of its authorities under the CEA to finalize and adopt the proposed amendment with substantive adjustments responsive to those comments. The Commission will additionally provide guidance herein regarding the Final Rule's implementation. The Commission believes that, in conjunction with the substantive and procedural clarifications and the compliance schedule discussed below, the Final Rule will facilitate compliance by exempt CPOs with new Regulation 4.13(b)(1)(iii), while also minimizing costs associated with implementing the amendment.[64]

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[61] AIMA, at 10.
[62] Willkie, at 8.
[63] IAA, at 12.
[64] Further, the Commission has determined that moving forward with the Final Rule, rather than re-proposing this amendment as requested by a few commenters, is an appropriate and acceptable course of action, consistent with the Commission's regulatory policies and goals, particularly given the substantive adjustments made in direct response to public comments and the provision of additional compliance time and guidance.

i. Prohibition v. Disclosure: Clarifying the Consequences of New Regulation 4.13(b)(1)(iii)

The Final Rule's amendment to Regulation 4.13 prohibits a person who has, or whose principals have, in their backgrounds a Covered Statutory Disqualification from claiming a CPO exemption thereunder, as opposed to requiring the disclosure of such disqualifications. As the Commission has previously stated, there is an undue risk posed to potential customers in the commodity interest markets, when a person can act as a CPO, including soliciting participants and accepting capital contributions in the name of its operated pool, without meeting the basic conduct standards set forth in the CEA. To address that risk, the Commission wishes to eliminate this inconsistent treatment between exempt and registered CPOs (and the principals thereof), in which certain persons may, by claiming an exemption from CPO registration, avoid the CEA's basic conduct requirements established for all persons registering as intermediaries with the Commission. The Commission understands that several commenters were generally opposed to prohibiting statutorily disqualified persons from claiming an exemption from CPO registration under Regulation 4.13.[65] After further consideration of the Proposal, the comments, and regulatory policy goals, the Commission believes that, for the purpose of ensuring its customer protection goals are met, it is important that all persons falling within the CPO definition not be subject to the most serious statutory disqualifications, prior to operating or soliciting participants for participation in their pools. The Commission finds this regulatory outcome of the Final Rule appropriate because, as discussed further below, persons claiming an exemption under Regulation 4.13 are

[65] *See, e.g.*, Dechert, at 7; SIFMA AMG, at 17.

exempt from the various regulatory obligations resulting from operating in a registered capacity.

Dechert commented that with respect to exempt CPOs, "the CFTC has generally determined it does not need to apply as close regulatory oversight … as it does for registered CPOs."[66] The Commission does not consider the Final Rule to be inconsistent with that statement. The Commission notes that, notwithstanding the Final Rule's amendment to Regulation 4.13, exempt CPOs will continue to be exempt from registration, and as a result, from the compliance obligations applicable to CPOs registered or required to be registered, which are primarily set forth in part 4 of the Commission's regulations. Each determination to exempt certain persons from CPO registration is inextricably linked to the eligibility criteria of the regulatory exemption being claimed. The Commission has previously concluded that such eligible persons generally implicate fewer of the Commission's regulatory and oversight interests, which supports the provision of a regulatory exemption from registration under those circumstances.[67] The Commission therefore believes it appropriate to recognize the unique regulatory status of exempt CPOs, but also to ensure that the Final Rule's amendment applies as intended and in a logical fashion.

Dechert further noted that, as an alternative to Proposed Regulation 4.13(a)(6) and to CPO registration generally, the Commission has multiple authorities it might employ and rely upon with respect to CPOs exempt under Regulation 4.13, citing the anti-fraud authority in CEA section 4*o*, as well as the recordkeeping and special call authorities in

[66] Dechert, at 7.
[67] See, e.g., 17 CFR 4.13(a)(3)(ii) (requiring CPOs claiming this exemption to comply with one of two de minimis thresholds for commodity interest trading in their exempt pool(s)).

Regulation 4.13(c)(1).[68] Although the Commission agrees that exempt CPOs are subject to these authorities, which the Commission may employ on an as-needed basis, none of them is equivalent to or establishes a basic conduct standard applicable to CPOs exempt under Regulation 4.13. Moreover, each of the cited provisions is most useful to the Commission where a discrete issue has been identified that requires the Commission to act; in contrast, the Commission intends new Regulation 4.13(b)(1)(iii) to apply prophylactically, providing a foundational level of customer protection to exempt pool participants. Therefore, the Commission believes that this approach to remedying the fundamental customer protection risk discussed above is appropriate, notwithstanding the logistical and regulatory concerns asserted by commenters regarding the implementation of new Regulation 4.13(b)(1)(iii).[69]

ii. Scope of the Final Rule: Which Statutory Disqualifications Will Be Grounds for Prohibiting a Claim to a CPO Exemption?

After consideration of the comments received regarding the statutory disqualifications that would be grounds for prohibiting a person from seeking to claim a CPO exemption, the Commission has determined not to include those violations enumerated in CEA section 8a(3) in the Covered Statutory Disqualifications. The Commission finds persuasive commenters' arguments that the offenses listed in CEA section 8a(3), in the context of Regulation 4.13, warrant different treatment than those offenses listed in CEA section 8a(2).[70] The Commission notes that due to their

[68] Dechert, at 7.

[69] As discussed in further detail below, the Final Rule will address those concerns by removing the proposed reference to the disqualifications in CEA section 8a(3) in the required representation and also by providing a meaningful period of time for compliance by currently exempt CPOs.

[70] See CEA section 8a(3), 7 U.S.C. 12a(3) (enumerating various disqualifications including: any violations of CEA or Commission regulations; any violations of the Securities Act of 1933, the Securities Exchange

characteristics, CEA section 8a(3) offenses (unlike those enumerated in CEA section 8a(2)) serve as a bar to registration with the Commission, only after a hearing is conducted to formally find both that the disqualification has occurred, and that the disqualification should prevent a person from registering with the Commission.[71] The Commission further believes that limiting the Covered Statutory Disqualifications that would result in a person being unable to rely upon Regulation 4.13 is consistent with the Commission's longstanding view that persons claiming an exemption from CPO registration generally implicate fewer of its regulatory concerns than those persons registered or required to be registered as CPOs.

The Commission notes further that Regulation 4.13 was designed to provide registration relief to CPOs with relatively limited activities in the commodity interest markets. Specifically, exempt CPOs are subject to substantive limitations impacting their exempt pools' commodity interest footprint or trading strategy, the types of pool participants they may solicit for investment in those exempt pools, as well as the exempt pools' overall size and marketing activities. The terms of the regulatory exemptions consequently cause the operations and activities of these exempt CPOs to be more narrowly circumscribed than those of registered CPOs. The Commission believes, as a result, that new Regulation 4.13(b)(1)(iii) should be tailored to the most serious offenses,

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Act of 1934, the IA Act, the Investment Company Act of 1940, among other federal statutes, as well as any similar state statutes and any related regulations; any failure to supervise that results in persons subject to such supervision violating the CEA or Commission regulations; willfully making materially false statements or omissions of fact in Commission reports, applications, disqualification proceedings, and other Commission proceedings; being subject to a denial, suspension, or expulsion order from a registered entity, registered futures association, or other self-regulatory organization; having a principal who has been or could be refused registration; and where there is other good cause).

[71] This process should be contrasted with that of CEA section 8a(2), the offenses of which may serve as the Commission's justification, upon notice, but without a hearing to refuse to register, to register conditionally, or to suspend or place restrictions upon the registration, of any person. 7 U.S.C. 12a(2). For persons already registered with the Commission, offenses under CEA section 8a(2) may also be cited by the Commission during such a hearing as may be appropriate to revoke the registration of any person. *Id.*

which can trigger a statutory disqualification without a prior hearing, *i.e.*, those listed in CEA section 8a(2).

Commenters also expressed confusion regarding the procedural implications of including the statutory disqualifications in CEA section 8a(3), particularly the hearing requirement, and how they might be incorporated into a new prohibition process under Regulation 4.13. IAA specifically requested that the Commission adopt a "reasonable person standard," with respect to a person's knowledge of statutory disqualifications, similar to Rule 506(d) of Regulation D, as adopted by the Securities and Exchange Commission (SEC).[72] The Commission believes, however, that limiting the representation in new Regulation 4.13(b)(1)(iii) to those offenses listed in CEA section 8a(2) will generally allow for effective implementation and will adequately address the Commission's customer protection concerns.

By focusing only on the offenses listed in CEA section 8a(2), the Commission is removing from the representation's purview those disqualifications that do not necessarily serve as a general bar to registration because they require a formal procedural hearing before they can impact a person's registration status with the Commission. By narrowing the scope of Covered Statutory Disqualifications in this manner, the Commission is also recognizing its historical position that the commodity interest activities of exempt CPOs generally implicate fewer of the Commission's regulatory concerns. As a result, the Commission believes that new Regulation 4.13(b)(1)(iii) will appropriately bar persons subject to the CSDs from claiming exemption under Regulation

[72] IAA, at 11 (requesting for disqualifications not to apply "if the entity did not know, and, in the exercise of reasonable care, could not have known that a disqualification exists," and citing 17 CFR 230.506(d)(2)(ii)-(iv) as example).

4.13, without the adoption of additional procedural requirements and without the adoption of a "reasonable person" standard, which may be difficult to apply in this circumstance. As such, the Commission believes that the Final Rule will still ensure that persons with the most egregious and recent offenses are unable to solicit and accept funds for participations in commodity pools, even if they are exempt, thereby strengthening overall confidence in pooled investment vehicles engaged in limited commodity interest trading.

iii. The Representation Requirement Under New Regulation 4.13(b)(1)(iii) and Retaining One of the Proposed Exceptions

The Final Rule will amend the notice requirement in Regulation 4.13 to require a representation that neither the person nor any of its principals has in their backgrounds a Covered Statutory Disqualification, subject to one limited exception discussed below.[73] The Commission intends for this representation to be a threshold requirement for any persons claiming an exemption subject to the notice requirement in Regulation 4.13. If a person cannot truthfully make the required representation regarding the person and its principals, then that person will not qualify for an exemption from CPO registration. As discussed in detail above, the representation in its final form has been narrowed in scope to the CSDs, *i.e.*, those offenses listed in CEA section 8a(2). Additionally, consistent with the Proposal, Family Offices relying on the new exemption in Regulation 4.13(a)(6), which are not subject to the notice filing requirement, will therefore also not be required to make the new representation. The Commission concludes that this is an appropriate regulatory outcome because Family Offices, by definition and by the substantive

[73] See infra new Regulation 4.13(b)(1)(iii).

requirements of that exemption, only serve "family clients," and thus, generally pose little customer protection risk to the investing public.

Proposed Regulation 4.13(a)(6) contained two exceptions: unless such disqualification arises from a matter which was previously disclosed in connection with a previous application, if such registration was granted, or which was disclosed more than thirty days prior to the claim of this exemption.[74] As mentioned above, NFA commented that the second exception "appears premised on the idea that the person claiming the exemption would be under an obligation, and have a method, to report an existing statutory disqualification to the Commission or NFA," and therefore, if the Commission or NFA did not act on it within thirty days, then the statutory disqualification would have no effect on the person.[75] NFA further pointed out that "unlike entities claiming relief under Advisory 18-96 and Regulation 4.7, which are registered and under an affirmative obligation to notify the Commission and NFA by updating their [registration forms] if they become subject to a statutory disqualification after they become registered, the vast majority of persons seeking an exemption under Regulation 4.13 are not [so] registered."[76]

The Commission agrees with NFA's description of how the second proposed exception was intended to apply, and also with NFA's assertion that many persons claiming a Regulation 4.13 exemption are not registered with the Commission in another capacity, meaning they have neither filed, nor have they any ongoing obligation to

[74] Proposal, 83 FR at 52927. As discussed above, this language is derived from other relief containing similar prohibitions. *See supra* pt. II.A.
[75] NFA, at 2.
[76] NFA, at 2 (suggesting therefore that the Commission "either eliminate this exception or limit it to persons that are currently registered").

update, registration forms with the Commission or NFA. After considering these comments, the Commission is therefore not adopting the second proposed exception. As a result, the remaining exception in new Regulation 4.13(b)(1)(iii) adopted by this Final Rule will apply to the Covered Statutory Disqualifications that have been previously disclosed by the person or its principal in prior registration applications that were granted. The Commission believes that this result maintains the strength of the amendment, while permitting flexibility for circumstances where the Commission has affirmatively determined that a CSD in a person's background should not impede that person's ability to register.

iv. Principal Classification and Treatment of RIAs

The Commission also received other substantive and procedural questions in response to Proposed Regulation 4.13(a)(6). Several commenters, for instance, claimed that it would be very burdensome for persons claiming exemption under Regulation 4.13 to identify, classify, and examine the principals within their business entities, and that requiring them to do so was effectively subjecting exempt CPOs to the most significant costs of intermediary registration with the Commission.[77] Regulation 3.1(a) defines the term "principal," by providing examples of who would be considered principals in a variety of legal entity structures, *e.g.*, sole proprietorship, limited liability company, limited partnership, or corporation.[78] Consistently though, the "principal" definition is,

[77] See, e.g., Dechert, at 7-8.

[78] 17 CFR 3.1(a). Additionally, Regulation 4.10(e)(1) also uses that "principal" definition for purposes of the Commission's part 4 regulations. 17 CFR 4.10(e)(1). NFA Registration Rule 101(t) is similar in design, and defines principal, in pertinent part, as "a proprietor of a sole proprietorship; a general partner of a partnership; a director, president, chief executive officer, chief financial officer or a person in charge of a business unit, division or function subject to regulation by the Commission of a corporation, limited liability company, or limited liability partnership; a manager, managing member, or member vested with management authority for a limited liability company or limited liability partnership; or a chief compliance

generally speaking, limited to those individuals and entities within the CPO who have either management authority and responsibilities, or significant power derived from stock ownership or capital contributions. Principals usually include, therefore, managing members, company presidents, corporate executives, chief compliance officers, and any legal person who is a ten percent or more shareholder of the person.[79] Dechert explained that "certain aspects of the [Commission's principal] definition … do not create a bright-line test, but rather require a facts-and-circumstances analysis."[80] Dechert further asserted that "the principal classification and screening process creates the majority of the work necessary to register CPOs and CTAs, and is costly," requested that the Commission provide guidance "as to how an exempt CPO could conduct such processes," and also asked that the Commission "establish[] a process for disagreement by the CFTC or NFA with an exempt CPO's determination."[81]

The Commission believes that preventing persons who have one or more statutorily disqualified principals from operating as exempt CPOs will generally increase the customer protection provided to participants in exempt pools, particularly because of the decision-making authority such principals may exercise regarding the operations of an exempt CPO and its exempt pool(s). The Commission also notes that several hundred CPOs currently maintain registration simultaneously with one or more CPO exemptions,

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officer." NFA Registration Rule 101(t), available at *https://www.nfa.futures.org/rulebook/rules.aspx?RuleID=RULE%20101&Section=8* (last retrieved Apr. 7, 2020).

[79] 17 CFR 3.1(a)(1)-(a)(3). Regulation 3.1(a)(4) additionally defines as a principal any person who employs a trust, proxy, contract, or other device to avoid becoming a ten percent or more shareholder for the purpose of evading being deemed a principal of the entity. 17 CFR 3.1(a)(4).

[80] Dechert, at 8 (citing "the head of business unit, division or function subject to CFTC regulation" as an example). Regulation 3.1(a)(1) includes in the "principal" definition, regardless of the entity's legal structure, any person in charge of a principal business unit, division or function subject to regulation by the Commission. 17 CFR 3.1(a)(1).

[81] Dechert, at 8 and 11.

due to the nature of the various commodity pools they operate. The Commission believes that such exempt CPOs may be slightly advantaged because they will likely spend less time identifying and classifying principals than persons or entities who have no prior contact with commodity interest markets or the Commission, or who only operate pools pursuant to one or more exemptions from registration. Registered CPOs, who may be also claiming a CPO exemption, will have already gone through those processes for purposes of applying for registration with respect to their non-exempt commodity pools. Further, such CPOs would also be much less likely to have to remove and replace principals with Covered Statutory Disqualifications. In the event such an otherwise registered CPO or a principal thereof did have a CSD, it would likely fall under the exception discussed above for CSDs identified by the person and/or principal in a prior approved application for registration, in light of their existing status as a registrant and the obligation to disclose such offenses as they occur.

With respect to persons claiming a CPO exemption under Regulation 4.13 for the first time, and persons who are exempt CPOs and not also registered with the Commission, the Commission understands that such persons will possibly be required to devote time and resources to determining who in their organization is a principal and whether any of them has a Covered Statutory Disqualification in their background. Some classes of principals under the Commission's regulations may involve a factual analysis to determine status. The Commission continues to believe, however, that most persons will be able to determine their principals relatively easily, due to the standard forms of business organization typically used by exempt CPOs and the detailed definitions

provided by the Commission in its regulations.[82] In particular, Regulation 3.1 details the roles, titles, ownership, and responsibilities that can give rise to a person being a "principal" of a registrant, which the Commission believes reduces the challenges associated with identifying principals within an organization such as an exempt CPO. As discussed above, the Commission also believes that some persons claiming Regulation 4.13 exemptions may have already been required to identify their principals as part of their registration with the Commission as a CPO with respect to the operation of one or more other pools. The Commission believes that the substantive changes made in this Final Rule address the Commission's concerns about providing some customer protection to participants in pools operated by an exempt CPO, while permitting flexibility and facilitating compliance with Regulation 4.13 through additional compliance time. Therefore, the Commission is adopting new Regulation 4.13(b)(1)(iii), such that the required representation covers both persons claiming the exemption and their principal(s).

The Commission also received several requests for the Commission to exclude RIAs from the proposed amendment, on the basis that such RIAs are already subject to robust conduct requirements in the IA Act, which, commenters argue, the new representation would only serve to duplicate.[83] Though the Commission agrees with commenters that RIAs are subject to conduct requirements under the IA Act, the Commission is declining to exclude RIAs from the scope of new Regulation 4.13(b)(1)(iii). IA Act section 203(e) covers censures, denials, or suspensions of registration for investment advisers and provides the SEC the authority to censure, limit,

[82] 17 CFR 3.1(a).
[83] *See*, *e.g.*, IAA, at 10; SIFMA AMG, at 18.

suspend, or revoke the registration of any investment adviser, if, after notice and opportunity for a hearing, certain statutory disqualifications of the adviser or persons associated with it are proven and such adverse action is in the public interest.[84] The Commission finds that the statutory disqualification regime of the IA Act differs materially from the corresponding provisions in the CEA. Of particular relevance to the Final Rule, the IA Act does not specify any statutory disqualifications that bar investment advisers from registration in a manner similar to the mechanism in CEA section 8a(2), *i.e.*, without a procedural hearing or order.

The Commission notes that preserving its independent authority to determine which persons should be permitted to operate commodity pools in its markets subject to an exemption is consistent with the Commission's independent assessment of RIAs seeking registration with the Commission regarding their commodity interest activities. Under those circumstances, notwithstanding the RIA's registration with the SEC, the Commission assesses the registration application of the RIA under the terms of the CEA and the Commission's regulations promulgated thereunder, which reflect the unique regulatory concerns associated with intermediaries in the commodity interest markets. Although the Commission recognizes that most RIAs would not present any cause for reservation in permitting them to operate in the commodity interest markets, the Commission believes that retaining the ability to engage in an independent assessment regarding an RIA's fitness to act as an exempt CPO best serves its customer protection

[84] IA Act section 203(e), 15 U.S.C. 80b-3(e).

interests. Therefore, the Commission is not adopting the suggestion to exclude RIAs from the scope of new Regulation 4.13(b)(1)(iii).[85]

v. Persons with Covered Statutory Disqualifications May Seek Individual Exemptive Letter Relief or Apply for CPO Registration

As explained herein, the Commission believes that the adoption of this representation regarding the Covered Statutory Disqualifications for persons, and their principals, claiming exemption under Regulation 4.13 is generally necessary to protect the participants in exempt commodity pools; however, the Commission recognizes that there may be facts and circumstances, pursuant to which permitting such disqualified CPOs and principals to operate exempt commodity pools may not be inconsistent with the Commission's customer protection concerns. The Commission notes its authority under Regulation 4.12(a) to "exempt any person or any class or classes of persons from any provision of this part 4, if it finds that the exemption is not contrary to the public interest and the purposes of the provisions from which exemption is sought."[86] The Commission has, by rule, delegated that authority to the Director of DSIO.[87] Pursuant to that delegated authority and Regulation 140.99, those persons who have a Covered Statutory Disqualification, but nonetheless believe that it should not negatively affect their ability to claim a CPO exemption, may seek, on an individual or firm-by-firm basis,

[85] The Commission notes, however, that the majority of RIAs, based on their registration status with the SEC, should be able to easily comply with the representation regarding Covered Statutory Disqualifications required by amended Regulation 4.13.
[86] 17 CFR 4.12(a).
[87] 17 CFR 140.93 (delegating the authority in Regulation 4.12(a) to the DSIO Director, further facilitating the issuance of exemptive letter relief with respect to provisions in 17 CFR part 4). As with all Commission delegations to staff generally: (1) the relevant Division Director (in this case, DSIO) may submit such a request regarding the delegated matter to the Commission for its consideration; and (2) the Commission may, at its election, exercise the delegated authority to consider such a request for relief. *See* 17 CFR 140.93(b)-(c).

exemptive letter relief from the representation adopted by this Final Rule by presenting the facts and legal rationale demonstrating that such exemptive letter relief would be consistent with the public interest and not contrary to the specific purposes of Regulation 4.13(b)(1), *i.e.*, providing some customer protection to exempt pool participants.[88] The Commission notes that it expects the granting of such requests to be infrequent and supported by a strong factual and legal basis, so as to avoid undermining the purposes of the Final Rule.

The Commission further advises that, at any time, even if a CPO is unsuccessful in its request for such exemptive letter relief, persons with CSDs may submit an application for CPO registration, in which any and all statutory disqualifications would be disclosed as required by Forms 7-R and 8-R, and reviewed through the existing registration process.[89] Utilizing this existing process allows for the detailed analysis of each disqualification, and all of the facts related thereto, specifically with respect to the propriety of the Commission permitting such person to register as a CPO, and/or to list a principal with any such disqualifications in its background. This assessment further includes determining whether any conditions or restrictions might sufficiently mitigate the customer protection risks posed by the statutorily disqualified person or principals.[90]

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[88] 17 CFR 140.99(a)(1) (defining an exemptive letter as "a written grant of relief issued by the staff of a Division of the Commission from the applicability of a specific provision of the Act or of a rule, regulation or order issued thereunder by the Commission"). Such exemptive letters are typically issued subject to conditions determined by Commission staff to be necessary or appropriate, and further, these letters are subject to Commission review prior to issuance.

[89] *See, e.g.*, 17 CFR 3.10.

[90] 7 U.S.C. 12a(2) (providing that the Commission has the authority to condition, restrict, or suspend the registration of any person under the Act). *See* also 17 CFR 3.60 (establishing the Commission's regulatory procedure to deny, condition, suspend, revoke, or place restrictions upon registration pursuant to sections 8a(2), 8a(3), and 8a(4) of the Act). The Commission has delegated the implementation of its registration authority to NFA. Performance of Registration Functions by National Futures Association, 49 FR 39593 (Oct. 9, 1984) (delegating by Commission Order the registration function to NFA with respect to futures commission merchants, CPOs, commodity trading advisors, and the associated persons thereof).

Should the determination be made to permit the registration, such persons would be subject to the Commission's ongoing oversight regarding their commodity pool operations, and subject to all statutory and regulatory obligations applicable to registered CPOs and their principals. The Commission believes that these existing procedures for seeking individualized exemptive letter relief under part 4 of the Commission's regulations, as well as the registration process, present appropriate methods for considering alternative outcomes, where appropriate, from the prohibition of Covered Statutory Disqualifications in exempt CPOs adopted herein.

vi. Timeframe for Exempt CPO Compliance with New Regulation 4.13(b)(1)(iii)

The Commission also received and considered multiple comments regarding the exact timing of the effective and compliance dates regarding Proposed Regulation 4.13(a)(6). As stated above, the Commission anticipates that the changes in approach employed in this Final Rule should reduce the analysis required in order to comply. Nonetheless, the Commission believes it appropriate to facilitate persons claiming an exemption under Regulation 4.13 in transitioning and adjusting to the application of new Regulation 4.13(b)(1)(iii). Although the Final Rule will be effective within 60 days of publication, the Commission has determined not to mandate compliance with the additional representation required by new Regulation 4.13(b)(1)(iii) for CPOs currently relying on an exemption in Regulation 4.13, as of that effective date. The Commission is establishing for these particular CPOs a compliance date of March 1, 2021, which coincides with the deadline for persons filing annual reaffirmation notices under Regulation 4.13(b)(1) in the upcoming 2021 filing cycle.

Although the Commission is declining to "grandfather" existing exempt CPOs with respect to the Final Rule, because it believes doing so may dilute any positive effect on customer protection the amendment would have, persons currently claiming an exemption from CPO registration may continue to do so, while identifying, classifying, and checking the backgrounds of the claiming person and its principals. The additional compliance period will allow currently exempt CPOs to continue operating their exempt pools, while they conduct the necessary inquiries regarding the claimant and principals (if they have not already been required to do so due to being otherwise registered).

On the other hand, persons claiming a Regulation 4.13 exemption for the first time on or after the Final Rule's effective date will not be provided additional compliance time. Publication of the Final Rule serves as notice to such persons that, to successfully claim an exemption from CPO registration, they will be thereafter required to identify their principals, conduct background checks, and represent that neither the person nor its principals are subject to the Covered Statutory Disqualifications, unless such offenses were disclosed in a registration application already approved by the Commission or NFA. The Commission believes this distinction between existing and new claimants under Regulation 4.13 is reasonable because persons establishing a new exempt CPO generally would have the opportunity to identify and check principals as part of the start-up process for the CPO and pool business, and prior to operating an exempt pool for the first time.

III. Related Matters

a. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires that Federal agencies, in promulgating regulations, consider whether the regulations they propose will have a

significant economic impact on a substantial number of small entities, and if so, to provide a regulatory flexibility analysis regarding the economic impact on those entities.[91] Each Federal agency is required to conduct an initial and final regulatory flexibility analysis for each rule of general applicability for which the agency issues a general notice of proposed rulemaking. The regulatory amendments adopted herein affect only persons registered or required to be registered as CPOs and persons claiming exemptions from registration as such. The Commission previously has determined that a CPO is a small entity for purposes of the RFA, if it meets the criteria for an exemption from registration under Regulation 4.13(a)(2).[92] Such CPOs will generally continue to qualify for the exemption from registration, though the Commission believes that such exempt CPOs claiming Regulation 4.13(a)(2) may incur some costs as a result of the Final Rule. Like most other exempt CPOs, they will also be required to identify their principals and affirm that neither they nor the claiming entity have in their backgrounds a Covered Statutory Disqualification. The Commission notes that this requirement will apply equally to all persons filing a notice of exemption under Regulation 4.13, after the effective date of the Final Rule, and that all CPOs currently claiming an exemption, including those that are small entities for RFA purposes, are subject to the guidance herein, requiring them to comply with new Regulation 4.13(b)(1)(iii) by March 1, 2021.

[91] 5 U.S.C. 601, *et seq*.

[92] Policy Statement and Establishment of Definitions of "Small Entities" for Purposes of the Regulatory Flexibility Act, 47 FR 18618, 18619-20 (Apr. 30, 1982). Regulation 4.13(a)(2) exempts a person from registration as a CPO when: (1) None of the pools operated by that person has more than 15 participants at any time, and (2) when excluding certain sources of funding, the total gross capital contributions the person receives for units of participation in all of the pools it operates or intends to operate do not, in the aggregate, exceed $400,000. *See* 17 CFR 4.13(a)(2). As of April 20, 2020, there are approximately 313 entities claiming this exemption.

The Commission did not receive any comments on its analysis of the application of the RFA to the Proposal or Proposed Regulation 4.13(a)(6).

The costs of new Regulation 4.13(b)(1)(iii), which are expected to vary depending on the size and complexity of the CPO in question, will generally be incurred once by exempt CPOs: either at the compliance date required by the Final Rule, or at the formation of a new exempt CPO after the Final Rule is effective. The Commission believes further that, as small entities which are typically less complex organizationally, CPOs exempt under Regulation 4.13(a)(2) may potentially have an easier time identifying, classifying, and verifying the backgrounds of their principals. As such, the Commission believes that such small CPOs will incur, in general, lower costs, especially when compared to other types of exempt CPOs that are more likely to employ complex business structures or have more principals to identify and review.[93] If an exempt CPO or its principal has a Covered Statutory Disqualification in its background, the Commission recognizes that such person could be significantly impacted, as the person would therefore likely be required to replace the disqualified principal to continue operating, or under some circumstances, may be required to even wind up and cease operating their pool(s) as an exempt CPO.

Throughout this Final Rule, the Commission has evaluated and taken into consideration the amendment's impact on small exempt CPOs. Though the Commission lacks sufficient data to predict exactly how many exempt CPOs may ultimately be required to cease pool operations by virtue of the Final Rule, the Commission expects

[93] Persons claiming an exemption under Regulation 4.13(a)(3), for example, include persons operating complex pooled investment vehicle structures that typically have at least several principals operating the CPO and pools.

very few CPOs exempt under Regulation 4.13(a)(2) will be required to cease operations as a result. The current number of exempt CPOs that are also small entities is relatively low (approximately 313), and the costs of new Regulation 4.13(b)(1)(iii) are generally limited in occurrence, as discussed above. Finally, the Commission is also providing guidance in the Final Rule that provides additional time for certain affected persons to comply and incur costs resulting from this amendment, as an effort to mitigate disruption to these businesses. Therefore, the Commission concludes that the Final Rule does not create a significant economic impact on a substantial number of small entities.

Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the regulation adopted by the Commission in the Final Rule will not have a significant economic impact on a substantial number of small entities.

b. Paperwork Reduction Act

The Paperwork Reduction Act (PRA) imposes certain requirements on Federal agencies in connection with their conducting or sponsoring any collection of information as defined by the PRA.[94] Under the PRA, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number from the Office of Management and Budget (OMB). The Commission believes that as adopted, the Final Rule results in a collection of information within the meaning of the PRA, as discussed below. As such, the publication of a PRA notice soliciting comment regarding the Commission's estimated burden calculation for new Regulation 4.13(b)(1)(iii) will be required.

[94] *See* 44 U.S.C. 3501, *et seq*.

As discussed in the Proposal, the Commission's proposed regulations would have impacted or amended two collections of information for which the Commission has previously received control numbers from OMB: Collections 3038-0005 and 3038-0023.[95] In the 2019 Final Rules, the Commission adopted amendments to 17 CFR part 4, submitted those final amendments for OMB approval, and amended those information collections to reflect the regulatory changes adopted by that final rulemaking.[96] Significantly, because Proposed Regulation 4.13(a)(6) was initially proposed as a substantive requirement to be applicable to any person who desires to claim an exemption under paragraphs (a)(1), (a)(2), (a)(3), (a)(4), or (a)(5) in this section, the Commission never considered the proposed amendment in the context of the PRA or those collections of information. In the Proposal, the Commission invited the public and other Federal agencies to comment on any aspect of the information collection requirements discussed therein.[97] The Commission did not receive any such comments.

As discussed above, the Final Rule adopts new Regulation 4.13(b)(1)(iii), which requires a person filing a notice of exemption under Regulation 4.13(b)(1) to represent that neither the claimant nor any of its principals has in their backgrounds a Covered Statutory Disqualification that would require disclosure, if the claimant sought registration with the Commission. Because Proposed Regulation 4.13(a)(6) did not require any additional information to be provided as part of the notice filed to claim an exemption under Regulation 4.13, the Commission did not account in the Proposal for any PRA burden associated with an additional representation in the notice filing required

[95] Proposal, 83 FR at 52918.
[96] *See* 2019 Final Rules, 84 FR at 67348; 84 FR at 67353.
[97] Proposal, 83 FR at 52920.

under Regulation 4.13(b)(1). Therefore, concurrent with the Final Rule, the Commission is updating the estimated burden associated with Regulation 4.13(b)(1), as amended by this Final Rule, and seeking public comment on those estimates in a PRA notice, separately published in this *Federal Register*.

c. Cost-Benefit Considerations

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA.[98] Section 15(a) further specifies that the costs and benefits shall be evaluated in light of the following five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the CEA section 15(a) considerations.

i. General Costs and Benefits

The baseline for the Commission's consideration of the costs and benefits of the Final Rule is the regulatory status quo, as determined by the CEA and the Commission's existing regulations. The Commission has endeavored to assess the costs and benefits of the Final Rule in quantitative terms wherever possible. Where estimation or quantification is not feasible, however, the Commission has provided its assessment in qualitative terms.

The Commission notes that the consideration of costs and benefits below is based on the understanding that the markets function internationally, with many transactions

[98] 7 U.S.C. 19(a).

involving U.S. firms taking place across international boundaries; with some Commission registrants being organized outside of the United States; with leading industry members commonly following substantially similar business practices wherever located. Therefore, the below discussion of costs and benefits refers to the effects of the Final Rule on all activity covered by the amended regulations. Consequently, the Commission notes that some entities affected by the Final Rule are located outside of the United States.

ii. Brief Overview of the Final Rule

The Final Rule adds new paragraph (b)(1)(iii) to the annual notice filing requirement in Regulation 4.13(b)(1), which will, once effective, require all persons filing a notice of exemption under Regulation 4.13 to represent that neither they nor their principals have in their backgrounds a Covered Statutory Disqualification, unless such disqualification arises from a matter which was disclosed in connection with a previous application for registration, if such registration was granted. The Commission intends for CPOs claiming a notice of exemption as of the Final Rule's effective date to first make this representation in the 2021 reaffirmation of the exemption, *i.e.*, March 1, 2021. The Commission believes that the adjustments to the Final Rule, discussed in detail above, as well as its guidance establishing an extended compliance period for currently exempt CPOs, address the majority of public comments received in response to Proposed Regulation 4.13(a)(6). The Commission concludes therefore that these efforts appropriately balance the Commission's regulatory interests with the costs of compliance to affected persons. New Regulation 4.13(b)(1)(iii) will effectively prohibit Covered Statutory Disqualifications, *i.e.*, those listed in CEA section 8a(2), in persons filing a

notice of exemption under Regulation 4.13, as well as in their principals, in a more tailored manner than the proposed amendment. As a result, the Commission believes the Final Rule addresses the Commission's customer protection concerns with respect to the exempt CPO population, while still reducing the regulatory burdens for exempt CPOs and their commodity pools.

ii. Benefits and Costs of the Final Rule

The Commission believes that prohibiting persons who are statutorily disqualified under CEA section 8a(2), or who employ principals so disqualified, from claiming exemptions under Regulation 4.13 will result in several benefits. As discussed in further detail above and in the Proposal, the Commission has concerns that "pool participants may be exposed to risk posed by regulations permitting the operation of an offered [exempt] pool by a person who, generally, would not otherwise be permitted to register with the Commission."[99] The Commission has noted that, "even if the activities of a CPO do not rise to a level warranting Commission oversight through registration, a prospective participant should be able to be confident that a collective investment vehicle using commodity interests is not operated by a person," who, for example, has previously been the subject of an injunction relating to fraud or embezzlement.[100]

Prior to the Final Rule, persons claiming an exemption from CPO registration under Regulation 4.13 generally were not required to meet any basic conduct standards, in contrast to persons registered or required to register as CPOs with the Commission.[101] The Final Rule remedies that regulatory gap by requiring that a person filing a notice of

[99] *See* Proposal, 83 FR at 52921.
[100] Proposal, 83 FR at 52921-22 (citing 7 U.S.C. 12a(2)(C)(ii) as an example of a disqualification proposed to be prohibited by this amendment).
[101] See *supra* pt. II.c.i for additional historical and legal discussion.

exemption from CPO registration under Regulation 4.13 meets substantively similar basic conduct standards as a person registered or required to be registered as a CPO. The Commission expects that correcting this regulatory inconsistency will increase overall investor confidence by setting a standard applicable to the vast majority of exempt CPOs operating pooled investment vehicles in the commodity interest markets. The result of the Final Rule will be that persons and/or principals who have a Covered Statutory Disqualification not previously disclosed in a prior approved application for registration will generally be prohibited from operating or soliciting the public for investment in exempt pools, or from serving as a principal of an exempt CPO.

Because the Final Rule will require such CPOs to assess themselves and their principals for any CEA section 8a(2) disqualifications, the Commission believes that once it is fully implemented, new Regulation 4.13(b)(1)(iii) may provide reasonable assurance that persons subject to the Covered Statutory Disqualifications are not soliciting exempt pool participants and/or managing their capital via exempt pools. Moreover, the Commission expects that both prospective and actual participants in pools operated by exempt CPOs will experience enhanced customer protection by removing statutorily disqualified CPOs and/or principals thereof from the commodity interest markets. The Commission believes further that those participants will likely, as a result, also experience improved overall confidence in the exempt commodity pool space.

The Commission understands that the Final Rule could also result in potentially substantial costs to persons filing a notice of exemption under Regulation 4.13(b)(1). In the Proposal, the Commission further identified and described "costs associated with either divesting from commodity interests held within a collective investment vehicle, or

in completely winding up a commodity pool's operations," that could result from Proposed Regulation 4.13(a)(6).[102] In addition to these "wind-up" costs, the Commission understands that principal identification and classification processes will likely result in costs to each affected exempt CPO, and that those costs will vary based on the overall structure of the CPO, the number of principals it employs, and other circumstances unique to its pool operations. Although these potential costs were a point of significant concern for several commenters, and the Commission specifically solicited comment in the Proposal on the "impact of adopting [Proposed Regulation 4.13(a)(6)] on industry participants and currently exempt CPOs," commenters did not provide specific data or estimates quantifying the actual costs of compliance resulting from the proposed amendment.[103]

Despite the lack of information from commenters regarding potential or actual costs to affected persons, the Commission nonetheless considered those public comments, and strove to balance those costs with its regulatory and policy goals in a way that benefits market participants, customers, and the general public interest. By narrowing the scope of the Covered Statutory Disqualifications in new Regulation 4.13(b)(1)(iii) to those listed in CEA section 8a(2), the Commission believes that the Final Rule strikes an appropriate regulatory balance between customer protection concerns and increased regulatory requirements. This adjustment means the required representation will target the most serious offenses warranting the statutory disqualifications listed in the CEA within the general population of exempt CPOs,

[102] Proposal, 83 FR at 52923 (though the Commission noted that it "lacks sufficient data to determine how many CPOs might be required to cease operating commodity pools pursuant to the exemptions … due to the presence of statutorily disqualified [persons or] principals").
[103] Proposal, 83 FR at 52916.

including their principals. Moreover, the Final Rule further reduces procedural confusion by limiting the CSDs to those disqualifications that would serve as a bar to registration with the Commission, absent an additional hearing or proceeding. Finally, by providing guidance herein that extends the compliance period for persons currently relying upon a claim of exemption under Regulation 4.13(b)(1), the Commission wishes to facilitate compliance with the Final Rule. Specifically, the Commission intends this guidance to mitigate the risk of business interruption by providing affected persons with additional time to assess themselves and their principals, and to identify and address any CSDs that are found. The Commission is employing this tailored and gradual approach for the Final Rule and its implementation to, among other things, generally moderate costs to affected persons caused by new Regulation 4.13(b)(1)(iii).

iii. Section 15(a) Considerations

1. Protection of Market Participants and the Public

The Commission considered whether the Final Rule will have any detrimental effect on the customer protections of the Commission's regulatory regime and has concluded that the Final Rule will generally have a positive effect on the protection of market participants and the public. Through new Regulation 4.13(b)(1)(iii), the Commission is remedying an inconsistency, in which a person who may be prohibited by the CEA from conducting activities requiring registration could nonetheless engage in those activities by claiming a CPO registration exemption instead. The Final Rule will ensure that persons filing a notice of exemption under Regulation 4.13(b)(1), as amended, and persons registered or required to be registered as CPOs with the Commission will be treated similarly – in either instance, all such persons must be able to represent that they

and their principals are, at a minimum, not disqualified under CEA section 8a(2), prior to soliciting the public for investment in, or otherwise operating a commodity pool. The Commission believes that basic conduct standards applicable to CPOs, regardless of registration status, will improve customer protection within the Commission's CPO regulatory program.

2. Efficiency, Competitiveness, and Financial Integrity of Markets

Section 15(a)(2)(B) of the CEA requires the Commission to evaluate the costs and benefits of a regulation in light of efficiency, competitiveness, and financial integrity considerations. The Commission believes that the Final Rule may positively impact the efficiency, competitiveness, and financial integrity of the commodity interest markets. The Final Rule will require all persons filing a notice under amended Regulation 4.13(b)(1) to represent that neither they nor their principals have in their backgrounds a Covered Statutory Disqualification. To the extent that disqualified persons are prevented from being an exempt CPO or from serving as a principal of an exempt CPO, as a result of new Regulation 4.13(b)(1)(iii), the Commission expects such disqualified persons (and principals) would either exit the commodity interest markets, or at least, discontinue operating in the exempt commodity pool space. Therefore, because it will ultimately cause the removal of entities, persons, and principals disqualified under CEA section 8a(2) from the exempt commodity pool space, the Commission believes that the Final Rule could have a positive impact on the efficiency, competitiveness, and financial integrity of the commodity interest markets overall.

3. Price Discovery

Section 15(a)(2)(C) of the CEA requires the Commission to evaluate the costs and benefits of a regulation in light of price discovery considerations. For the reasons noted above, the Commission believes that the Final Rule generally results in limited, discrete changes to regulatory processes and filings that will not have a significant impact on price discovery.

4. Sound Risk Management

Section 15(a)(2)(D) of the CEA requires the Commission to evaluate a regulation in light of sound risk management practices. The Commission believes that the Final Rule will not have a significant impact on the practice of sound risk management because the manner in which various CPOs, pooled investment vehicles, and their respective principals organize, register, or claim an exemption from such registration has only a small influence on how such market participants manage their risks overall.

5. Other Public Interest Considerations

Section 15(a)(2)(E) of the CEA requires the Commission to evaluate the costs and benefits of a regulation in light of other public interest considerations. The Commission did not identify any additional public interest considerations not already discussed above.

d. Anti-Trust Considerations

Section 15(b) of the CEA requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the purposes of the CEA, in issuing any order or adopting any Commission rule or regulation (including any exemption under CEA section 4(c) or 4c(b)), or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 17 of the

CEA.[104] The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. The Commission requested comment on whether the Proposal implicated any other specific public interest to be protected by the antitrust laws and received no comments addressing this issue.

The Commission has considered the Final Rule to determine whether it is anticompetitive and has identified no anticompetitive effects. Because the Commission has determined the Final Rule is not anticompetitive and has no anticompetitive effects, the Commission has not identified any less anticompetitive means of achieving the purposes of the CEA.

List of Subjects in 17 CFR part 4

Advertising, Brokers, Commodity futures, Commodity pool operators, Commodity trading advisors, Consumer protection, Reporting and recordkeeping requirements.

For the reasons stated in the preamble, the Commodity Futures Trading Commission amends 17 CFR part 4 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, 6(c), 6b, 6c, 6*l*, 6m, 6n, 6*o*, 12a, and 23.

2. Amend § 4.13 by renumbering paragraph (b)(1)(iii) as (b)(1)(iv), revising paragraph (b)(1)(ii), and adding new paragraph (b)(1)(iii), to read as follows:

§ 4.13 Exemption from registration as a commodity pool operator.

[104] 7 U.S.C. 19(b).

* * * * *

(b)(1) * * *

(ii) Specify the paragraph number pursuant to which the person is filing the notice (*i.e.*, § 4.13(a)(1), (2), (3), or (5)) and represent that the pool will be operated in accordance with the criteria of that paragraph;

(iii) Represent that neither the person nor any of its principals has in its background a statutory disqualification that would require disclosure under section 8a(2) of the Act if such person sought registration, unless such disqualification arises from a matter which was disclosed in connection with a previous application for registration, where such registration was granted; and

* * * * *

Issued in Washington, DC, on June 5, 2020, by the Commission.

Robert Sidman,

Deputy Secretary of the Commission.

Note: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors: Prohibiting Exemptions Under Regulation 4.13 on Behalf of Persons Subject to Certain Statutory Disqualifications—Commission Voting Summary, Chairman's Statement, and Commissioners' Statements

Appendix 1—Commission Voting Summary

On this matter, Chairman Tarbert and Commissioners Quintenz, Behnam, Stump, and Berkovitz voted in the affirmative. No Commissioner voted in the negative.

Appendix 2—Supporting Statement of Chairman Heath P. Tarbert

As Robert Louis Stevenson aptly put it, "Everybody, sooner or later, sits down to a banquet of consequences."[1]

Today we are focused on the consequences of bad acts that result in "statutory disqualification" under the Commodity Exchange Act ("CEA"). These acts include the most serious types of financial crimes, such as embezzlement, theft, extortion, fraud, misappropriation, and bribery. Once an individual is statutorily disqualified, the CFTC may deny or revoke his or her registration. The same is true for corporate entities.

It stands to reason that someone who has been statutorily disqualified—and thus has no right to register with the CFTC—would be precluded from managing other people's money and positions in the derivatives markets the CFTC regulates. But currently, this is not exactly the case. As it turns out, a statutorily disqualified person who wishes to operate a fund that trades derivatives may simply claim one of the exemptions from registration as a commodity pool operator ("CPO") under CFTC Rule 4.13. Although each of these exemptions has a number of conditions, the absence of statutory disqualification is not currently among them.

Today's final rule closes this loophole for bad actors. Under our rule as amended, a CPO claiming a registration exemption would be required to certify that neither the CPO nor any of its principals has in its background conduct that would result in automatic statutory disqualification under the CEA. I believe this rule will enhance

[1] While this is the popular rendering of Stevenson's quote, it appears to be apocryphal. Stevenson apparently used the phrase "game of consequences." See Spurious Quotations, The Robert Louis Stevenson Archive, *http://www.robert-louis-stevenson.org/richard-dury-archive/nonquotes.htm*. Regardless whether Stevenson referred to a banquet or a game, his point was the same: everyone must face the consequences of his or her actions. That is true for life generally, and for the derivatives markets specifically.

customer protections and public confidence in the integrity of the derivatives markets by ensuring that bad actors cannot gain access to the funds of innocent, third-party investors simply by filing an exemption claim.[2]

In so doing, we also strike a balance between bad acts that warrant automatic disqualification and other behavior that requires the opportunity for a hearing before the subject is disqualified. Because the CEA itself makes this kind of distinction in the context of registration, the Commission believes that lesser offenses[3] warrant different treatment than recent and more serious offenses in the context of registration exemptions. Thus, today's prohibition on statutory disqualification does not include offenses for which the CEA itself requires a hearing prior to disqualification.

I am comfortable with this exclusion, both because it is consistent with legislative intent and because CPOs relying on a Rule 4.13 registration exemption generally do not manage the money and derivatives positions of the retail public at large. Rather, these CPOs are limited by the terms of their exemption to small pools of select participants,

[2] The Commission has adopted a registration exemption for CPOs that meet the definition of "family office" under the Securities and Exchange Commission's regulations governing investment advisers. 84 Fed. Reg. 67,368 (Dec. 10, 2019). Section 409 of the Dodd-Frank Act excluded family offices from the definition of "investment adviser" subject to the Investment Advisers Act. Given the clear legislative intent to remove family offices from regulation, it would be inappropriate for the CFTC to exert its own oversight over such offices. As Congress recognized in the Dodd-Frank Act, regulatory oversight over family offices would be a wasteful use of taxpayer funds, as such offices are owned and controlled by a single wealthy family. Given their affluence and familial ties, these investors generally neither desire nor need investor protections designed for the retail public at large. Consistent with this approach, today's prohibition on statutory disqualification does not apply to CPOs that are family offices. That said, we cannot allow bad actors to operate a family office in a way that adversely affects the market as a whole—for example, by engaging in manipulative or deceptive transactions through the family office. To that end, I have asked the Division of Swap Dealer and Intermediary Oversight to conduct a special call to determine how many family office managers would be prohibited from claiming the exemption if they were covered by this rule.

[3] This includes offenses that are less recent (e.g., felony convictions that are more than ten years old) or are less relevant to a person's fitness to handle customer funds (e.g., convictions for felonies that do not involve financial wrongdoing). See, e.g., CEA Section 8a(3)(D).

pools limited to sophisticated investors, pools with de minimis derivatives positions, and the like.[4]

In addition to protecting customers from bad actors and enhancing the integrity of the derivatives profession, this rule also furthers the CFTC's strategic goal of "being tough on those who break the rules."[5] No longer will financial wrongdoers be able to use registration exemptions as a loophole to avoid the full consequences of their actions. For these reasons, I am pleased we are acting to finalize this rule.

Finally, it is worth remembering that sound regulation of the U.S. derivatives markets stems from a robust federal framework that the CFTC primarily administers, complemented and strengthened by an equally robust regime of self-regulation. A central pillar of that regime is the National Futures Association ("NFA"), the main self-regulatory organization for CPOs. NFA's strong support for this rule is just one of countless actions that demonstrate their steadfast commitment to the integrity of the derivatives community.[6]

Appendix 3—Supporting Statement of Commissioner Brian Quintenz

[4] The rule also excludes statutory disqualifications that were previously disclosed to the Commission in a registration application, if the Commission chose to permit registration notwithstanding the disqualification. This exclusion is relevant because a CPO may be registered with the CFTC with respect to certain pools that it manages and claim a registration exemption with respect to other pools.
[5] See Draft CFTC 2020-2024 Strategic Plan, 85 Fed. Reg. 29,935 (May 19, 2020), *https://www.govinfo.gov/content/pkg/FR-2020-05-19/pdf/2020-10676.pdf*.
[6] See NFA Comment Letter on Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors (Dec. 17, 2018).

I am pleased to support today's final rule amending the procedures for certain commodity pool operators (CPOs) to claim an exemption from registration.[1] It is sound policy to prevent a firm from claiming a registration exemption if the entity or its principals are "statutorily disqualified" under section 8a(2) of the Commodity Exchange Act, when the same disqualification would prevent them from registering with the Commission. The disqualification applicable under today's amendment covers some of the most serious offenses under the Act, including fraud. While an exempt CPO is more limited in its activities than a registered CPO, for example, no pool has more than 15 participants[2] or the CPO's commodity interest activity must remain below certain initial margin and notional amount thresholds,[3] an exempt CPO still manages money for the public. I therefore agree with today's amendment that the firm should be held to one of the most fundamental customer protection standards under the Commodity Exchange Act.

I thank the Commission's staff for their work on this rulemaking, in particular for their thoughtful responses to issues that had been raised by commenters.

[1] Amended Commission regulation 4.13(b)(1)(iii) (17 CFR 4.13(b)(1)(iii)).
[2] Commission regulation 4.13(a)(2).
[3] Commission regulation 4.13(a)(3).

Appendix 4—Concurring Statement of Commissioner Rostin Behnam

I support today's adoption of a final rule (the "Final Rule") requiring any person that files with the CFTC a notice claiming an exemption from registration as a commodity pool operator ("CPO") under Regulation 4.13 of the Commodity Exchange Act ("CEA" or the "Act") to affirmatively represent that neither the claimant nor any of the CPO's principals has in its background any statutory disqualifications listed in section 8a(2) of the CEA, which are required to be disclosed as a part of a CPO registration application with the Commission. Beyond closing a regulatory gap that allows certain persons that would generally fail to meet the CEA's basic conduct requirements to nevertheless claim an exemption from CPO registration, the Final Rule invigorates the Commission's stance as an active regulator with respect to the most diverse registration category within our jurisdiction. As I have said before, CPOs (and commodity trading advisors or "CTAs") are often identifiable by variable organizational structures, investment focus, participation, and solicitation, as well as complexity in how they are regulated within our authority.[1] These factors demand that when we act, we do so with a laser focus on customer protections. I am pleased that this Final Rule aggressively advances customer protection in a tangible way.

I believe it is fully within our statutory duty to provide, at the very least, a foundational level of security on which customers, regardless of their experience and aptitude, can rely when parsing and considering what can seem like an endless amount of important information and fine print. Today's Final Rule provides that footing for

[1] Rostin Behnam, Statement of Concurrence by CFTC Commissioner Rostin Behnam: Amendments to Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors, Nov. 25, 2019, *https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement112519*.

exempt commodity pool participants by generally prohibiting persons who have, or whose principals have, in their backgrounds any of the statutory disqualifications listed in CEA section 8a(2)—which are generally egregious, recent in time, and based upon a previous finding or order by the Commission, a court, or another governmental body—from soliciting and accepting funds for participation in commodity pools, even if they are exempt.

I am pleased that the Final Rule and its preamble address the significant number of responsive public comments, especially those seeking clarity on process and procedure. Last fall, when the Commission finalized several amendments to Part 4 of the regulations addressing various registration and compliance requirements for CPOs and CTAs, I commended, among other things, its decision to not move forward at that time on the part of the proposal that led to today's Final Rule.[2] That decision has led to a more thoughtful consideration of the comments received, the practicalities of the proposal, and the Commission's need to fulfill its regulatory goals while remaining true to the Act. To that end, I appreciate that the Final Rule preserves the Commission's direct and delegated authorities under CEA section 8a(2) and Regulation 4.12(a) to ultimately evaluate fitness for registration—or exemption, as the facts may dictate.

[2] *Id.*

Appendix 5—Statement of Commissioner Dan M. Berkovitz

I support today's final rule to prohibit commodity pool operators ("CPOs") or their principals who are subject to statutory disqualification under Section 8a(2) from claiming an exemption from registration. This rule narrows a loophole in our CPO registration framework and strengthens the Commission's regulations to protect customers and market integrity.

Section 8a(2) of the Commodity Exchange Act ("CEA") lists the offenses for which the Commission may refuse, suspend, or condition registration without a prior hearing. These offenses include major violations of a number of laws and regulations governing financial markets, including felony convictions for embezzlement, theft, extortion, and fraud.[1] Today's rule will ensure that persons who are restricted under Section 8a(2) from operating in registered activities cannot escape such restrictions by engaging in activities that are exempt from registration.

Although to a large degree this rule closes an existing loophole in our regulations, it perpetuates a glaring deficiency by failing to hold CPOs of family offices or their principals to the same standards of conduct as other exempt CPOs. The risks to market integrity presented by this omission are compounded by another recent rulemaking exempting CPOs of family offices from a requirement to notify the Commission if they claim an exemption from registration.[2] Thus, under this set of new rules completed today, CPOs of family offices are exempt from registration, exempt from providing notice that they are using an exemption, and exempt from the statutory disqualifications

[1] CEA Section 8a(2)(D)(iii).
[2] Final Rule, Registration and Compliance Requirements for Commodity Pool Operators (CPOs) and Commodity Trading Advisors: Family Offices and Exempt CPOs, 84 FR 67355 (Dec. 10, 2019).

that generally apply to all other CPOs. This triad of exemptions for CPOs of family offices leaves the Commission uniquely unaware of the activities and integrity of these entities.

As I noted in my dissent on the final rule that exempted CPOs of family offices from notifying the Commission that they are claiming an exemption, family offices today are not "mom and pop" operations that invest small sums in commodities, but rather large and sophisticated asset management enterprises established by and for mega-millionaires and billionaires.[3] The Commission justified these exemptions on the grounds that related family members in these "sophisticated" entities do not need the customer protections that the CFTC otherwise applies to CPO activities. However, regardless of whether this assessment is accurate, customer protection is just one of several objectives of the Commission's CPO regulations. The regulation of CPOs facilitates the Commission's oversight of the derivative markets, management of systemic risks, and mandate to ensure safe trading practices.[4] There is no basis to conclude that the activities of large family office CPOs pose less of a concern in these areas than the activities of other exempt or non-exempt CPOs.

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[3] Dissenting Statement of Commissioner Dan M. Berkovitz: Rulemaking to Provide Exemptive Relief for Family Office CPOs: Customer Protection Should be More Important than Relief for Billionaires, *available at https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement112519*.

[4] *See, e.g.*, Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, 77 FR 11252, 11253, 11275 (Feb. 24, 2012); upheld in *Investment Company Institute v. CFTC*, 720 F.3d 370 (D.C. Cir. 2013). In Section 4l of the CEA, Congress declared, "the activities of commodity trading advisors and commodity pool operators are affected with a national interest in that, among other things . . . their operations are directed toward and cause the purchase and sale of commodities for future delivery . . . and the foregoing transactions occur in such volume as to affect substantially transactions in contract markets." 7 U.S.C. 6l.

The regulatory principle here is straightforward. We are not only responsible for monitoring market participants that pose risk to customers, but also those who pose risk to the integrity of our markets. Individuals who commit felonies or other serious violations affecting the integrity of financial markets should not be permitted to trade in CFTC markets, particularly without at least some supervision and oversight. If a CPO of a family office or one of its principals has engaged in conduct serious enough to be subject to the disqualification provisions of Section 8a(2), such as fraud or misappropriation, then it should seek registration with the Commission and be subject to our oversight.

However, I am pleased that at my request, the CFTC staff will be making a special call to CPOs of family offices to determine how many, if any, are subject to statutory disqualification under Section 8a(2). The Commission currently has no information in this regard. I have consistently supported basing our regulatory decisions on the best available data. The data we will obtain from this special call will inform our judgment about whether further action is necessary to protect customers and the market.

I also am pleased that the Commission has declined to exclude registered investment advisers from the scope of this rule. The Securities and Exchange Commission has a different statutory disqualification regime. Registrants should abide by CFTC rules when they operate in our markets.

Going forward, the Commission should propose similar restrictions on the claiming of exemptions by statutorily disqualified commodity trading advisors. While this rule narrows one of the gaps in our Part 4 regulatory framework, this additional significant gap remains and should be closed.

I would like to thank the staff of the Division of Swap Dealer and Intermediary Oversight for working with my office to incorporate some of our comments and proposed revisions to this rule. As a matter of course, a collaborative rulemaking process that takes into account the input from all five Commissioners will produce better regulations.