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NAVIGATING THE COMPLEX WORLD OF COMMODITY FUTURES:

A Guide to CFTC and NFA Regulation

Overview of the Commodity Futures Trading Commission (CFTC) and the National Futures Association (NFA)

The Commodity Futures Trading Commission (CFTC) is an independent agency of the United States government tasked with promoting the integrity, resilience, and vibrancy of the United States derivative markets through sound regulations. The Commodity Exchange Act, passed in 1936, has established the statutory framework under which CFTC operates. The National Futures Association (NFA) is a self-regulatory organization for United States derivatives industry, which was established by CFTC to regulate practices of its members.

The NFA is the sole registered future association established by CFTC; the CFTC provides oversight to the NFA and its duties (such as by regularly assessing whether the NFA is adequately meeting its obligations to examine members for compliance with relevant provisions of Commodities Exchange Act). The NFA and the CFTC actively work together to accomplish this mission.

The NFA has 6 membership categories:

- Commodity Pool Operator (CPO)
- Commodity Trading Advisor (CTA)
- Futures Commission Merchant (FCM)
- Forex Dealer Member (FDM)
- Introducing Broker (IB)
- Swap Dealer (SD)

If a manager intends to invest a fund's assets in any futures, options on futures, forex (foreign currency), swaps or other related derivatives products, **the manager will need to determine if it needs to register as a commodity pool operator ("CPO") or a commodity trading advisor ("CTA") with the CFTC and become a member of the NFA.**

Moreover, if the manager is required to register with the CFTC as a CPO or CTA, **at least one individual must register as an associated person ("AP") of the manager and also be listed as a principal of the manager.**

Overview of Commodity Pool Operators (CPOs) and Registration Criteria

A Commodity Pool Operator (CPO) is an individual or organization that operates a commodity pool and solicits funds for that commodity pool. **A commodity pool is an enterprise in which funds contributed by a number of persons are combined for the purpose of trading futures or options on futures, retail off-exchange forex contracts, or swaps, or to invest in another commodity pool.**

CPO registration is required unless the CPO qualified for certain exemptions under CFTC Regulations 4.5 or 4.13, as detailed below. **If CPOs qualify for an exemption from registration, they must electronically file a notice through NFA's filing system.**

More information on the annual affirmation process can be found here. To summarize the annual affirmation process, if a CPO is claiming exemptions for registration with the NFA, entities must file the affirmation within 60 days of the calendar year-end through the NFA's exception filing system with certain information as specified by the NFA.

If the entity/person does not qualify for registration exemptions provided, they must be registered with the NFA as a member with the following requirements:

1. Designate a security manager in order to obtain access to NFA's online registration system
2. Complete only form 7-R
3. Complete online NFA membership registration
4. Pay a non-refundable application fee of $200
5. Complete online annual questionnaire
6. Pay non-refundable CPO membership dues

If an entity or person is registered as a CPO, CPO members must distribute monthly or quarterly account statements to investors within 30 days of closing with certain exceptions. CPO members must also distribute annual audited financial statements (audited by an independent public accountant) to investors within 90 days of the CPO's fiscal year end or permanent ceasing of trading. CPOs are also required to file this report (audited financial statements) with the NFA electronically.

Overview of Commodity Trading Advisor (CTAs) and Registration Criteria

A Commodity trading advisor (CTA) is an individual or organization that, for compensation or profit, advises others, directly or indirectly, as to the value of or the advisability of buying or selling futures contracts, options on futures, retail off-exchange forex contracts or swaps.

- **Direct advice** includes exercising trading authority over a customer's account or providing commodity trading advice based on, or tailored to, the commodity interest or cash market positions or other circumstances or characteristics of particular clients.
- **Indirect advice** includes giving advice through written publications or other media.

CTA registration is required unless the CTA qualified for certain exemptions under CFTC Regulation 4.14, such as:

- Advice was provided to 15 or fewer persons during the past 12 months and the entity does not generally hold itself out to the public as a CTA; or
- A manager who, in the preceding 12 months, has not furnished commodity trading advice to more than 15 persons and who does not hold itself out generally to the public as a CTA is exempt from CTA registration. See CEA § 4(m)(1) and CFTC Rule 4.14(a)(10).

CFTC Rule 4.14(a)(10) provides additional guidance regarding how a manager relying on this exemption should count clients toward the 15-client limit:

- Non-U.S. firms need only count U.S.-resident clients towards the 15-client limit.

In addition, the exemption provides that a manager shall not be deemed to hold itself out generally to the public for purposes of Section 4m(1) solely because the manager participates in a non-public offering of interests in a collective vehicle (e.g., a private offering of securities exempt from registration under the 1933 Act).

- Entity is CFTC registered, and advice is solely incidental to its business or profession; advice regarding commodity trading is issued solely in connection with their employment.

CTA registration under CFTC Regulation 4.14(a)(5) is available for an exempt CPO that is acting as a trading advisor to its own fund. For this relief to apply, two conditions need to be met:

1. The CPO must be exempt from registration as a CPO under CFTC Regulation 4.14(a)(4) and must be registered under the CEA as a CPO and,
2. The person's commodity trading advice must be directed solely to, and for the use of, the fund(s) for which it is so exempt.

The entity should include a disclaimer in all written publications or other media that the advice provided is not based upon knowledge of or tailored to a customer's particular trading account or trading activity.

If CTAs qualify for an exemption from registrations, they must electronically file a notice through NFA's filing system. More information on the annual affirmation process can be found here.

If a CTA is claiming exemptions for registration with NFA, CTAs must file the affirmation within 60 days of the calendar year end through NFA's exception filing system with certain information as specified by NFA.

If CTAs are not exempt and must register with the NFA as a member, CTAs must do the following:

1. Designate a Security Manager in order to obtain secure access to NFA's Online Registration System (ORS)
2. Complete online Form 7-R
3. Complete the online NFA membership application
4. Pay a non-refundable application fee of $200
5. Complete the online Annual Questionnaire
6. Pay non-refundable CTA membership dues

For Principals and Associated Persons (AP) of CTAs, the following steps are required to register with NFA:

1. Complete online Form 8-R for each principal and AP
2. Submit fingerprint cards
3. Satisfy proficiency requirements for each sole proprietor, AP, forex AP and swap AP
4. Pay non-refundable application fee of $85 for each principal or AP

An application fee for principals and APs is not required if the individual is currently registered with the CFTC in any capacity or is listed as a principal of a current CFTC registrant. Only one application fee is required if the individual is filing an application as both an AP and Principal.

Additionally:

- One principal of the CTA must be an AP
- One principal of a forex CTA must be a forex AP
- One principal of a swap CTA must be a swap AP

Registration requirements:

- Note that all registered CPOs and CTAs MUST be NFA members. To become a NFA member, click here
- CPOs registration requirements
- CTAs registration requirements

Exemptions for CPOs

CFTC regulations 4.13 and 4.5 allow certain CPOs to be exempt from registration; CFTC regulations 4.7, 4.12, 4.23, and 4.13 (a) (5) grant CPOs certain relief from some of regulatory requirements. Note that CPOs claiming 4.5, 4.13(a)(1), 4.13(a)(2), 4.13(a)(3), 4.13(a)(5), or 4.14(a)(8) must annually affirm the applicable notice of exemptions or exclusion within 60 days of the calendar year end.

The NFA website shows more in depth for exemptions and what each exemption entails.

It's crucial to note that all these filings must be made online via the NFA's official website to ensure a streamlined and efficient registration process. The use of the online system facilitates timely and accurate submissions, thereby expediting the overall registration and compliance procedures.

A brief review of these exemptions is listed below:

EXEMPTION FROM CPO REGISTRATION	
EXEMPTION	**QUALIFICATION**
4.13(a)(1) - Pool exemption for CPOs that operate one pool at a time	An entity acting as a pool operator where the following applies: 1. Person operates only one pool at any time; 2. Does not advertise; 3. Does not receive compensation; and 4. Is not otherwise required to be registered with the CFTC and is not a business affiliate of any person required to register with the CFTC.
4.13(a)(2) - Small Pool Exemption	An entity acting as a pool operator where the following applies: 1. Person operates pool(s) with total gross capital contributions in all pools operated or intended to be operated that do not exceed $400,000 and none of the pools operated has more than 15 participants at any time. 2. Persons that can be excluded from the 15 participants: (1) the pool's operator and CTA and their principals, (2) any of their children, siblings or parents, (3) the spouse of any of these persons, and (4) any relative of these persons, including a relative of a spouse who has the same principal residence.
4.13(a)(3) - Pool with minimal commodity interest trading	An entity acting as a pool operator where the following applies: 1. Exemption provides relief from CPO registration in cases where the pool trades only minimal amount of futures. 2. With the exception of non-U.S. investors, participation is restricted to accredited investors, a trust formed by an accredited investor for the benefit of a family member, knowledgeable employees, and QEPs. 3. Generally, participations in the pool are not marketed as a vehicle for trading in the commodity futures or commodity options markets. At all times, pool meets one of two tests below (see CFTC Regulation 4.13(a)(3)(ii) for details): a) The aggregate initial margin, premiums, and minimum security deposits do not exceed 5% of the liquidation value of the pool's portfolio, or

	b) The aggregate net notional value of positions does not exceed 100% of the liquidation value of the pool's portfolio.
4.5 – Exclusion from CPO definition for pools already regulated by another regulatory authority	An entity acting as a pool operator where the entity is one of the following: 1. An Investment Advisor registered under the Investment Advisors Act of 1940 that operates an investment company under the Investment Company Act of 1940 or operates a business development company that elected an exemption from registration as an investment company under the Investment Company Act of 1940; 2. An insurance company subject to state regulations; 3. A bank, trust or any other such financial depository institution subject to U.S. regulation; or 4. A trustee of a named fiduciary or an employer maintaining a pension plan that is subject to ERISA. Furthermore, if the person claiming the exclusion is an Investment Advisor, then the pool must be operated as follows: 1. For bona fide hedging purposes: a) Where derivatives trading will not exceed 5% of the liquidation value of the qualifying entity's portfolio or b) Where the aggregate net notional values of the entity's commodity interest positions do not exceed 100% of the liquidation of the pool's portfolio. 2. And where it will not be, and has not been, marketing participation to the public as a commodity pool or otherwise or as a vehicle for trading in commodity futures, commodity options or swap markets.
4.14(a)(8) – CTA exemption for those that advise exempt pools	**An entity acting as a trading advisor where the following applies:** 1. CTA who only provides advice to pools operating under a 4.13(a)(3) exemption, to pools operated as a registered investment adviser of 4.5 exempt pools, and to pools that are organized and operated outside of the United States; 2. Provides commodity interest advice solely incidental to its securities advice; and 3. Does not otherwise hold itself out as a CTA.

Exemption that provides relief to registered CPOs from certain regulatory requirements

4.7 – Pool with all Qualified Eligible Persons (QEPs)	A registered CPO that offers or sells participations in a pool solely to QEPs as defined in CFTC Regulation 4.7.
4.7(b)(5) [formerly 4.7(b)(4)] – Third-Party Recordkeeping relief for 4.7 Exempt Pools	A registered CPO that has filed a 4.7 exemption.
4.12(b) – Pool trading primarily securities with limited investment in commodity interests	A registered CPO that operates a pool where the following applies: 1. The pool will be offered and sold pursuant to Securities Act of 1933 or related exemption. 2. The pool will generally and routinely engage in the buying and selling of securities and securities related instruments. 3. The pool will not enter into commodity interest transactions in which the aggregate initial margin, premiums, and minimum security deposits exceeds 10% of the fair market value of the pool's assets. 4. The pool will trade commodity interests in a manner solely incidental to securities trading activities.
4.12(c)(2) – Pools that are commodity Exchange Traded Funds (ETFs)	A registered CPO that operates a pool where the following applies: 1. The pool will be offered and sold pursuant to Securities Act of 1933. 2. The pool is listed for trading on a national securities exchange.
4.12(c)(3) – Substituted Compliance for Registered Investment Companies (RICs)	A registered CPO that operates a pool that is registered under the Investment Company Act of 1940.
4.13(a)(5) – Relief from CPO registration for a director or trustee of an Exchange Traded Fund (ETF)	A director or trustee of an ETF operated by a registered CPO.
CFTC Advisory 18-96 – CPOs who operate offshore commodity pools	A registered U.S. CPO that operates offshore pools that only accept non-U.S. participants.
4.23(c) – Third-Party Recordkeeping relief for CP	A registered CPO.

Exemption that provides relief to registered CPOs from certain regulatory requirements, continued.

4.7 – Relief from certain requirements for CTAs that advise Qualified Eligible Persons (QEPs)	A registered CTA whose clients meet the definition of QEP in CFTC Regulation 4.7.
4.7(c)(2) – Third-Party Recordkeeping relief for CTAs with a 4.7 Exemption	A registered CTA that has filed a 4.7 exemption.
4.33 – Third-Party Recordkeeping relief for CTAs	A registered CTA.

If a CPO or CTA is operating a pool that qualifies as a fund of funds and needs additional time to file an audited Annual Report, the notice required by CFTC Regulation 4.22(f)(2) must be filed with NFA by the Annual Report's original due date (within 90 days of the calendar year end).

Any extension request must be filed with NFA prior to the report's original due date. However, CPOs or CTAs that are requesting an extension beyond 180 days after the pool's fiscal year-end must file the request with the CFTC.

CPOs or CTAs that have previously filed this fund of funds notice do not need to file in subsequent years. The due date will be automatically extended.

Conclusion

As a registered Commodity Pool Operator (CPO) or Commodity Trading Advisor (CTA), navigating CFTC regulations can be complex. This white paper serves as a thorough guide to the exemptions and relief provisions available to you, including compliance substitutions for investment companies and third-party recordkeeping relief.

Key points to remember:

- The criteria and relief provided by exemptions like 4.12(c)(3), 4.13(a)(5), 4.23(c), and 4.7.
- The requirements for third-party recordkeeping relief under 4.7(c)(2)/4.7(b)(5) and 4.33.
- The deadlines and procedural details for filing extension requests for audited Annual Reports under 4.22(f)(2).
- The crucial importance of compliance to maintain these valuable exemptions and reliefs.

Stay informed, stay compliant, and ensure you're making the most of the regulations designed to assist you in your operations. For help demystifying these regulations and how Richey May can help, **reach out to Steve Vlasak, Business Development Partner, Alternative Investments Practice.**

Bibliography:

Commodity Pool Operator (CPO) Members | NFA, https://www.nfa.futures.org/members/cpo/index.html.

Commodity Trading Advisor (CTA) Members | NFA, https://www.nfa.futures.org/members/cta/index.html.

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