

CFTC Staff Updates Requirements for the Delegation of CPO Functions

On May 12, 2014, the Commodity Futures Trading Commission (“CFTC”) staff issued Letter 14-69 (the “Letter”), which requires that specific no-action relief be obtained when a commodity pool operator (“CPO”) of a fund delegates its rights and obligations as a CPO to another entity that will serve as the registered CPO of the fund. The Letter institutes a streamlined approach to facilitate requests for no-action relief and supersedes the Staff’s prior guidance (the “Guidance”) issued in August 2012 (discussed in a previous Ropes & Gray Alert, available [here](#)).

Background

Historically, the CFTC staff has considered a private fund’s general partner, manager or board of directors to be the fund’s CPO. Accordingly, a fund manager that uses special purpose entities to serve as general partners or limited liability company managers of the funds it advises, or that has individual directors for its funds, may have multiple CPOs, each of which would be required (absent no-action relief from the CFTC) to register separately as a CPO or claim an applicable exemption. The August 2012 Guidance stated that the general partner, managing member or board of directors of a commodity pool may delegate its CPO rights and obligations to another person, provided that such delegation is permitted by the commodity pool’s organizational documents and the laws of the jurisdiction in which the commodity pool is organized. The Guidance required that the delegate must be qualified to serve as a CPO, be registered as a CPO, and agree to assume such CPO rights and obligations, and that the delegating entity must agree to remain jointly and severally liable with respect to any violations of the Commodity Exchange Act (the “CEA”). The Guidance was perceived by the industry as making generally applicable relief previously granted in staff no-action letters to individual fund sponsors, so that a fund manager would be required to register only itself as a CPO with respect to the funds it advises, instead of having to register each of its special purpose entities and individual directors, provided that the conditions and requirements discussed above were met.

Subsequent to the issuance of the Guidance, during routine periodic examinations of registered CPOs, staff of the National Futures Association (“NFA”) began requesting that CPOs who had entered into delegation agreements obtain no-action letters from the CFTC staff. Likewise, certain exchanges required copies of no-action letters in connection with applications for exchange memberships by funds. Further, NFA examiners recently began contacting CPOs in connection with their review of 2013 audited financial statements and asking whether no-action requests had been submitted. When CPOs submitted requests for no-action relief in these circumstances (or otherwise after the Guidance was issued), the CFTC staff generally did not respond.

The Letter provides welcome relief from the confusion and impasse that followed the issuance of the Guidance. Although it is unclear why individual requests for no-action relief must be obtained instead of either simply requiring that delegation agreements¹ be in place or requiring a notice filing (as is done to claim various registration exemptions) that delegation agreements are in place, the Letter does provide for a streamlined process when certain criteria are met, whereby a form of request is completed and filed and relief is granted on an expedited basis.

¹ The Letter makes clear that the requisite provisions can be in a separate delegation agreement, an investment management agreement or a document that establishes the fund, as long as it is a legally binding document.

Criteria for Streamlined Relief

The CFTC staff set forth the following criteria that must be satisfied in order to qualify for the streamlined relief:

1. a. The Delegating CPO has delegated to the Designated CPO all of its investment management authority with respect to the commodity pool in a legally binding document;
- b. The Delegating CPO does not participate in the solicitation of participants for the commodity pool; and
- c. The Delegating CPO does not manage any property of the commodity pool.
2. The Designated CPO is registered as a CPO.
3. The Delegating CPO is not subject to a statutory disqualification.
4. There is a business purpose for the Designated CPO being a separate entity from the Delegating CPO that is not solely to avoid registration by the Delegating CPO under the CEA and the CFTC's regulations.
5. The books and records of the Delegating CPO with respect to the commodity pool are maintained by the Designated CPO in accordance with Regulation 1.31.
6. If the Delegating CPO and the Designated CPO are each a non-natural person, then one such CPO controls, is controlled by, or is under common control with the other CPO.
7. If a Delegating CPO is a non-natural person, then such Delegating CPO and the Designated CPO have executed a legally binding document whereby each undertakes to be jointly and severally liable for any violation of the CEA or the CFTC's regulations by the other in connection with the operation of the commodity pool.
8. If a Delegating CPO is a natural person and is not an Unaffiliated Board Member,² then such Delegating CPO and the Designated CPO have executed a legally binding document whereby each undertakes to be jointly and severally liable for any violation of the CEA or the CFTC's regulations by the other in connection with the operation of the commodity pool.
9. If a Delegating CPO is an Unaffiliated Board Member, then such Delegating CPO must be subject to liability as a Board member in accordance with the laws under which the commodity pool is established.

These criteria are helpful in the case of Delegating CPOs who are individuals and not affiliated with the Designated CPO, such as independent directors. The Letter clarifies that in such instances, the individual does not have to be under common control with the Designated CPO and does not have to retain joint and several liability for CEA or CFTC rule violations with the Designated CPO. Unfortunately, Item 1b raises a question in the case of an affiliated individual Delegating CPO, such as an inside director, in that it appears to require that the inside director not participate in the solicitation of investors for the fund. Although inside directors do solicit investors in the funds, they are not doing so in their capacity as directors but rather as registered Associate Persons ("APs") of the registered CPO. It would seem that since they are acting as registered APs, the streamlined process would be available. Also, if the streamlined process were available to the independent directors only, that could lead to a strange situation where the independent directors could

² For purposes of the Letter, "Unaffiliated Board Member" means a natural person who is a voting member of the board of directors or an equivalent governing body of the commodity pool who (i) is not a member of the management or an employee of the Designated CPO or any affiliate thereof; (ii) is not a substantial beneficial owner of the Designated CPO or any affiliate thereof or of any company holding more than 5% of such Designated CPO's beneficial ownership interests or any affiliate thereof; and (iii) has no other interest or relationship that could interfere with his/her ability to act independently of management of the Designated CPO or any affiliate thereof or of any company holding more than 5% of such Designated CPO's beneficial ownership interests or any affiliate thereof.

obtain no-action relief and delegate to the registered CPO, but the inside director could not and would be a co-CPO with the registered CPO of which it is a registered AP. We are consulting with the staff on this issue. Further, the Letter does not harmonize the CPO registration analysis for private funds with that for registered investment companies. For registered investment companies that are commodity pools, the CFTC considers the advisor to be the CPO, not the individual directors.³ It is unclear why directors are deemed to be CPOs of private funds but are not considered to be CPOs of funds that are registered investment companies.⁴

Application for Relief

CPOs should re-examine their delegation agreements in light of the enumerated criteria, and consider whether any updates are desirable. Persons that satisfy the enumerated criteria may request relief from the staff through the streamlined approach by completing a request letter in the form attached to the Letter. A single request for relief may be filed by a Delegating CPO with respect to multiple commodity pools. Those that do not satisfy the enumerated criteria must submit a formal request for relief in accordance with the standard no-action process. Persons that have previously submitted a formal request for relief from registration and have not received a response, but satisfy the enumerated criteria may submit a request for relief through the streamlined approach. The Letter does not affect the efficacy of any prior staff letters with respect to CPO registration relief for a Delegating CPO.

Please contact [Deborah Monson](#), [Jeremy Liabo](#) or the Ropes & Gray attorney who usually advises you with any questions you may have or if you would like additional information.

³ See 77 Fed. Reg. 11252 at 11259 (Feb. 24, 2012).

⁴ The Letter does not address delegation for CPOs relying on CFTC Rule 4.13(a)(3), so there continues to be no guidance in that regard.