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CFTC Staff Announces Streamlined Process for CPO Delegation

On March 12, 2014, the Commodity Futures Trading Commission (CFTC) staff issued the long-awaited guidance letter relating to the delegation of commodity pool operator (CPO) functions from persons that might otherwise be subject to CPO registration to registered CPOs. For non-natural persons delegating CPO functions to the registered CPO, the relief from registration is conditioned on the CPO that is delegating its authority (the "Delegating CPO") controlling, being controlled by, or being under common control with, the registered CPO (the "Designated CPO"). Notably, the new staff letter removed the previous requirement that "unaffiliated directors" of the commodity pool that would be considered CPOs agree to be jointly and severally liable with the registered CPO for violations of the Commodity Exchange Act or the CFTC's regulations by the registered CPO. The streamlined no-action relief is not self-executing but rather must be applied for with the CFTC to be claimed. The staff letter is available here.

Background

In order to coordinate filing obligations for the CFTC and the Securities and Exchange Commission (SEC)[1] and for tax reasons, many CPOs wish to delegate their obligations to related commodity trading advisors or other affiliated entities that are registered CPOs. Under previous CFTC no-action letters, the criteria required for delegation were not always clear. The new staff letter is meant to provide clear and consistent guidance on when CPO delegation will be permitted in order to facilitate the no-action process, but will not adversely affect no-action relief that was previously granted.

Criteria

The new staff letter sets forth specific criteria for the approval of CPO delegations. The criteria are:

- The Delegating CPO must have delegated to the Designated CPO all of its investment management authority with respect to the commodity pool pursuant to a legally binding document.
- The Delegating CPO must not participate in the solicitation of participants for the commodity pool or manage any property of the commodity pool.
- The Designated CPO must be registered as a CPO with the CFTC.
- The Delegating CPO must not be subject to a statutory disqualification.

[1] One of the principal reasons for CPO delegations is that a registered investment adviser's reporting with the Securities and Exchange Commission under Form PF may be used to fulfill part of the filing requirements for the CFTC's Form CPO-PQR if the same person is filing each.

- There must be a business purpose for the Designated CPO being a separate entity from the Delegating CPO other than solely to avoid the Delegating CPO registering with the CFTC.
- The books and records of the Delegating CPO with respect to the commodity pool must be maintained by the Designated CPO in accordance with CFTC Regulation 1.31.
- If the Delegating CPO and the Designated CPO are each a non-natural person, then one must control, be controlled by, or be under common control with the other.
- Delegating CPOs that are (i) non-natural persons or (ii) board members other than “unaffiliated board members”[2] must execute a legally binding document with the Designated CPO in which each party undertakes to be jointly and severally liable for any violation of the Commodity Exchange Act or the CFTC’s regulations by the other party in connection with the operation of the commodity pool.
- “Unaffiliated board members” that are Delegating CPOs must be subject to liability as a Board member in accordance with the laws under which the commodity pool is established.

Process

The new staff letter itself includes a form of no-action request that a Delegating CPO would file with the CFTC, including identifying information about the Delegating CPO and the Designated CPO, and certifications by the Designated CPO and Delegating CPO regarding satisfaction of the criteria set forth in the new staff letter. Unfortunately, the no-action letter request must be submitted pursuant to the process set forth in CFTC Regulation 140.99 in paper form instead of by email.

[2] “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. Whether a director has an interest or relationship under clause (iii) will be based on the relevant facts and circumstances. For example, interests or relationships that are indicative of an affiliation with the Designated CPO that could trigger clause (iii) may include: the director being a material service provider or investment counterparty to the Designated CPO or any of its affiliates, or is, or within the past three years was, employed in an executive capacity by, or was a principal or employee of, a material service provider or investment counterparty to the Designated CPO or any of its affiliates.

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