U.S. Regulatory Roadmap

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CompliGlobe Ltd.

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Cover all the bases …

For a non-U.S. fund: register or exempt the **securities** from SEC registration under the Securities Act of 1933

Register or exempt the **investment adviser** from SEC registration under the Investment Advisers Act of 1940

For a private fund, exempt the **fund** from being an investment company under the Investment Company Act of 1940

Register or exempt the **seller of the securities** as a broker under the Securities Exchange Act of 1934

Register as or be an exempt **CTA** or **CPO**: Commodity Exchange Act

Do not forget: FCPA, FATCA and Internal Revenue Code (tax) issues

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What is an "investment adviser"?

- Under the Advisers Act, an investment adviser is any person that
  1. for compensation
  2. is engaged in the business of providing investment advice about securities or investments: giving or acting upon research, advice or recommendations
  3. to others: private funds *or* separately managed accounts ("SMAs")
- Providing investment advice is
  - Discretionary (decisions taken and effected by the adviser, no client involvement)
  - Advisory (active client involvement - discussions and giving research, advice or recommendations - *but no trading: client trades on their own*)
- As adviser, sub-adviser, AIFM or fund GP/Trust trustee or LLC managing member
- If a non-U.S. person uses the "means of interstate commerce" (post, fax, e-mail, visit, instant messaging, social media, phone or web site access), it becomes amenable to SEC jurisdiction and must satisfy an exemption, register with the SEC or cease the activity
- A "participating affiliate", if compliant with SEC Staff no-action letters, does not register with the SEC as an RIA

Who is a "U.S. person"?

- This definition is based on *residence,* as defined in Rule 902 of Regulation S under the Securities Act
  - Individuals: where they *reside*
  - Partnership or corporation:
    - if not organised in a U.S. state, it is not a U.S. person; *however*
    - it *would* be a U.S. person if it was (i) organized or incorporated under the laws of any foreign jurisdiction and (ii) formed by a U.S. person principally for the purpose of investing in securities not registered under the Securities Act, unless it was organized or incorporated, and owned, by accredited investors (as defined in Regulation S who are not natural persons, estates or trusts
  - Trusts, estates, etc: the location of trustees, executors
  - Investment managers: where its clients reside

If you want to manage assets for U.S. persons?

1. No involvement with the United States?
   - No need to register as an investment adviser with the SEC under the Advisers Act ("RIA") or file a report to become an Private Fund Adviser
2. Manage U.S. money directly in SMAs, not via a private fund
   - Satisfy the Foreign Private Adviser exemption or become an RIA
3. You want to manage U.S. money *only* in a private fund
   - Use the Private Fund Adviser exemption and become an "Exempt Reporting Adviser" ("ERA") or become an RIA
4. You want to manage U.S. money in SMAs *and also* in a private fund
   - If you have 15 or more U.S. clients (direct or in a private fund) or more than $25m from any or all of these clients, you must become an RIA

- If you are an affiliate of an RIA it wants you to provide it with research, advise or recommendations for it to use for its U.S. clients and you do not wish to become an RIA
  - Become a "participating affiliate"

What is a “private fund”?

A company, LLC, partnership, LLP, unit trust or other pooled investment vehicle that is not an investment company for purposes of the 1940 Act because it:

- does not have more than 100 U.S. person beneficial owners – the Section 3(c)(1) exemption (rarely used)

- has only U.S. persons that are “qualified purchasers” (never more than 499 in any one fund) – the Section 3(c)(7) exemption

“Regulatory assets under management”

- Includes *all* securities portfolios subject to continuous and regular management, including:
  - Proprietary assets
  - Assets managed for no compensation
  - Assets of non-U.S. clients
- In the case of a private fund:
  - Uncalled capital commitments of a private fund
  - Leveraged assets
  - All assets, regardless of the type of assets held by that fund
- Sub-adviser must include only assets over which it actually provides advisory services
- Include all gross assets without any deductions for debt or leverage
- Value private fund assets at fair value

Exemption: "Foreign Private Adviser"

1. No place of business in the United States;
   - Avoid U.S. activity, directly or indirectly
2. Fewer than 15 U.S. clients in SMAs *and* U.S. investors in a private fund;
   - Add both – direct and indirect U.S. persons
3. Aggregate "regulatory assets under management" ("RAUM") of less than $25m attributable to the U.S. clients in #2 above;
4. Does not hold itself out in the United States as an adviser; *and*
   - *Be careful with press releases, articles, conferences, visits and events*
5. Does not advise SEC registered investment companies ("RICs") or SEC registered business development companies

Exemption: "Private Fund Adviser"

1. As regards U.S. residents, an adviser only to private funds *and*
2. For assets managed from a location in the United States, aggregate RAUM of no more than $150m, determined annually

3. "Rules of the road"
   – U.S. firms count RAUM managed from their U.S. location
   – For non-U.S. firms
      - Cannot have U.S. person SMAs – only private funds
      - the $150m cap does not apply
      - count U.S. persons and aggregate U.S. person RAUM across all private funds
      - run the Foreign Private Adviser and Private Fund Adviser tests together so that if you have more than 15 U.S. person investors or RAUM of more than $25m from them, become a Private Fund Adviser to avoid full registration
      - exclude any private fund that (1) is not incorporated in the United States, (2) is not marketed to U.S. persons and (3) does not have U.S. person investors

Implications

If a non-U.S. person uses the means of interstate commerce to provide investment advice to a U.S. person, it has these choices:

- Cease the activity – *no contact*
- Stay under the U.S.$ 25m and 15 U.S. person caps and be a Foreign Private Adviser – *very limited contact*
- Become a Private Fund Adviser and take U.S. person funds only via a private fund – *limited contact*
- Become an RIA – *full contact*

Do not forget:

- *If the non-U.S. adviser manages U.S. person assets directly, it cannot be a Private Fund Adviser*
- *Always apply the Foreign Private Adviser and Private Fund Adviser exemptions at the same time*

"Participating Affiliates"

- An affiliate of an RIA that gives research, advice or recommendations to the RIA for it to use for or give to its U.S. clients
- Must demonstrate *bona fide* affiliation through "control"
- Cannot "engineer" a participating affiliate relationship to avoid registration – this is doing indirectly what cannot be done directly (Advisers Act Section 208(d))

Participating Affiliates are established through a series of SEC Staff no-action letters, reaffirmed by the SEC itself in Release 3222

Mercury Asset Management plc (16 April 1993); *Kleinwort Benson Investment Management Limited, et al.* (15 December 1993); *Murray Johnstone Holdings Limited, et al.* (7 October 1994)*; ABN AMRO Bank N.V., et al.* (1 July 1997); *and Royal Bank of Canada, et al.* (3 June 1998). *See also União de Banco de Brasileiros S.A. (28 July 1992)*

What is required for Participating Affiliates?

- "Participating affiliate" does not have to register with SEC
  - Must sign a participating affiliate agreement
  - Relevant personnel are "associated persons" that comply with the RIA's Code of Ethics personal account dealing requirements
  - May give only research, advice and recommendations
  - Must keep records of what it does for the RIA
  - SEC must have adequate access to trading and other records of the participating affiliate
  - Form ADV Part 2 disclosure of associated persons
- RIA must exercise oversight over and supervise the participating affiliate in its role – failure to supervise is actionable under Advisers Act Section 203(e)(6)
- The participating affiliate no-action letters were issued by the Staff of the SEC's Division of Investment Management ("IM") pursuant to delegated authority – cannot give orders
  - The no-action letters only deal with matters arising under Advisers Act Sections 203 and 208(d)
  - Because the letters were issued by IM pursuant to delegated authority and not the Staff of the SEC's Division of Market Regulation ("MR", now Trading and Markets), IM had no authority to pass on matters outside the Advisers Act – in particular, the Exchange Act and brokerage. This would have required action by MR and MR took no positon in these letters

March 2017 IM Guidance on participating affiliates

- Noted background to the participating affiliate letters and the giving of "assurances" (no-action) if the conditions of the letters are followed
- IM received "a wide variety of documents" seeking to rely upon the documentation requirement of the no-action letters
- The Guidance stated that documentation of the following "general representations and undertakings" "addresses most clearly the concerns" raised in the no-action letters and the SEC Staff then repeated in detail the advisory points noted in the previous slide
- What the Guidance *did not do*
  - Did not discuss what could or could not be done – as such, it continues to be the case, absent a further grant of no-action relief, that associated persons may only provide advice, research or recommendations to the RIA and may not exercise discretion over a client portfolio or give the RIA orders to buy or sell securities
  - Did not advance a change in the no-action letters or anticipate rule-making
- Indications
  - OCIE is reviewing participating affiliate arrangements in examinations
  - Enforcement referrals?
- As of today, no developments

What is a “broker”?

- The term “broker” is defined in Section 3(a)(4) of the Exchange Act as “any person engaged in the business of effecting transactions in securities for the account of others”

- According to the SEC and the SEC Staff, if a firm uses the means of interstate commerce to, for U.S. persons,
  - solicit and/or effect transactions in securities
  - receive unsolicited orders to buy or sell securities
  - receive transaction-based compensation, directly or indirectly
  - hold itself out as such (e.g. directly or by being amenable …)

  it would be a “broker” and, absent an exception, exemption, rule or no-action letter, must (1) cease the activity, (2) use an SEC registered broker-dealer or (3) register as a broker-dealer with the SEC – or face being sued by the SEC

- Covers … trading, M&A activities, soliciting the purchase or sale of the securities of a private fund

Even the U.S. courts have a view

"To qualify as a broker, the activities of the alleged broker must be characterized by a certain regularity of participation in securities transactions at key points in the chain of distribution" and be "engaged in the business" of securities transactions".

SEC v. Zubkis, No. 97 Civ. 8086, 2000 WL 218393, (S.D.N.Y. Feb. 23, 2000); *accord SEC v. Hansen*, No. 83 Civ., 3692, 1984 WL 2413 (S.D.N.Y. Apr. 6, 1984), *Massachusetts Financial Services, Inc. v. SIPC*, 411 F.Supp. 411, 415 (D. Mass. 1976), *aff'd* 545 F.2d 754 (1st Cir. 1976), *cert. denied* 431 U.S. 904 (1977); *MuniAuction, Inc*., SEC No-Action Letter, 2000 WL 291007 (March 13, 2000). *See also Massachusetts Financial Services, Inc. v. SIPC.*, 411 F. Supp. 411 (D. Mass. 1976).

What does this mean for a non-U.S. firm?

- Are we dealing with “securities” under the U.S. federal securities laws (watch out for cryptocurrencies and bitcoins)? If yes,
- Am I holding myself out, taking orders, soliciting U.S. client orders to buy the securities of a private fund, soliciting brokerage or receiving unsolicited orders to buy or sell securities? If yes,
- Are the means of interstate commerce involved? If yes,
- Does the Exchange Act give me an “exception”? If no,
- Does a rule apply (Rule 15a-6 or Rule 3a4-1) or a “safe harbor”? If no,
- Is there a relevant interpretation or would a Rule 15a-6 FAQ cover me? If no,
- Has the SEC given me an exemption (derogation)? If no,
- Is there a no-action letter on point? If no,

1. register with the SEC as a broker
2. use an SEC registered broker-dealer
3. do not engage in this activity!

Relevant SEC Staff no-action letters

Under delegated authority, SEC Staff issued no-action letters providing that an Adviser that transmits orders to brokers/banks for execution, does not hold client funds or securities, does not solicit a client for an order, does not send the client research with the purpose of receiving an order *and* does not receive transaction-based compensation for these activities is not required to register with the SEC as a broker-dealer

- *This posits no client involvement in the process of effecting a transaction – from research through formation of advice or recommendation to placing the order, execution and matching, clearing and settlement*
- See *First Atlantic Advisory Corp*. (20 February 1974), *McGovern Advisory Group, Inc*. (7 August 1984) and *In Touch Global LLC* (14 November 1995)

No-action relief denied where the adviser's activities were more extensive e.g. soliciting brokerage or sending research

- *This posits client-facing involvement designed to obtain, receive or effect an order to buy or sell securities*
- See e.g. *PRA Securities Advisers LP* (3 March 1993)

Exemption from BD registration: Rule 15a-6

- Exemption from Exchange Act broker-dealer registration for non-U.S. entities that would be a "broker" or "dealer" and that engage in certain activities with U.S. investors using the means of interstate commerce
- Rule 15a-6 permits (subject to compliance with its conditions)
  1. Sending research to and soliciting *major U.S. institutional investors*
  2. Soliciting and executing trades with or for *U.S. institutional investors* - restrictions on calling, visiting and sending research
  3. Executing *un*solicited transactions with U.S. persons – hard to establish and, despite the Rule 15a-6 SEC Staff *FAQs* permitting "more than one" such transaction, not possible for expanded brokerage activities or solicitations
  4. Engaging in "principal to principal" trades directly with registered broker-dealers and certain other enumerated entities
- Other than 3 above, Rule 15a-6 is not available when dealing with individuals
- A U.S. person cannot rely upon Rule 15a-6

Key definitions for Rule 15a-6

- *Solicitation:* coined in 1989 when the SEC adopted Rule 15a-6 and given it a broad meaning -- even a single act to open an account or encourage a person to buy or sell a security is a solicitation. This remains in place today. *See* "Registration Requirements for Foreign Broker-Dealers", Exchange Act Release 27017, 54 FR 30013 (13 July 1989)
- *Major U.S. institutional investor*: an entity that owns, controls or has under management more than $100m in aggregate financial assets
- *U.S. institutional investor*: RIC; a bank, savings and loan association, insurance company, business development company, small business investment company or employee benefit plan defined in Securities Act Regulation D Rule 501(a)(1); a private business development company defined in Rule 501(a)(2) of Regulation D; an organisation described in Section 501(c)(3) of the U.S. Internal Revenue Code of 1986; or a trust defined in Rule 501(a)(7) of Regulation D

Rule 15a-6 FAQs

- Question 9 of Rule 15a-6 FAQs treats when a few more than one *bona fide* unsolicited transaction exemption *for the same U.S. investor* would attract SEC scrutiny
- Paraphrasing FAQ 9, the SEC Staff stated that it would not ordinarily consider one transaction in compliance with Rule 15a-6(a)(1) as preventing more than one such transaction, but caveated this as being evident of a solicitation. Noting, the SEC Staff continued, that solicitation is broadly interpreted, it cited factors from the 1989 Rule 15a-6 Adopting Release that would be evident of a solicitation:
  - calls from a firm to a client encouraging use of the firm to effect transactions
  - advertising directed into the United States of one's function in this respect
  - recommending the purchase or sale of particular securities, with the anticipation that the client would execute the recommended trade through the firm

- E-mails, blotter entries, visit records and other firm records would be used, forensically, to establish a pattern of solicitation or receiving “unsolicited” orders

FAQ 9 cont'd

- Continuing, the SEC Staff stated that "a series of frequent transactions or a significant number of transactions between a foreign broker-dealer and a U.S. investor as being indicative of solicitation through the establishment of an "ongoing securities business relationship"
- Thus, and because non-U.S. firms that were not registered as a broker could not provide the protections that an SEC registered broker-dealer could, engaging in a few more than one unsolicited transaction carries with it significant risks
- FAQ 9 refers to "the same U.S. investor". It does not address two or more U.S. investors of a foreign firm. As such, non-U.S. firms would be advised not to try to apply FAQ 9 to more than one of their U.S. clients at the risk of being deemed to be an unregistered broker, outside the parameters of Rule 15a-6(a)(1) and in violation of the Exchange Act's broker-dealer registration requirements

Selling the securities of a private fund

- In IA Release 3222 (2011) adopting the Dodd-Frank exemptions from Advisers Act registration, the SEC stated that “persons who market interests in a private fund may be subject to the registration requirements of section 15(a) under the [Exchange Act]" and that ‘‘[s]olicitation is one of the most relevant factors in determining whether a person is effecting transactions”
- This was issued by the Commission itself, not the Staff
  - The focus was the solicitation of the securities of private funds
  - It was silent on transaction-based compensation
  - It was silent on whether/if it applies in other contexts – such as the solicitation of brokerage, direct or indirect, or a client giving an adviser an order
- Firms should proceed on basis that this Commission interpretation might“trump” Staff no-action letters on brokerage and that solicitation by itself might be enough to kick-off the broker-dealer registration requirements - enforcement actions will “clear the way”

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 275

[Release No. IA–3222; File No. S7–37–10]

RIN 3235–AK81

Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

80a–3), but for section 3(c)(1) or 3(c)(7) of that Act."

[9] Interests in a private fund may be offered pursuant to an exemption from registration under the Securities Act of 1933 (15 U.S.C. 77) ("Securities Act"). Notwithstanding these exemptions, the persons who market interests in a private fund may be subject to the registration requirements of section 15(a) under the Securities Exchange Act of 1934 ("Exchange Act") (15 U.S.C. 78o(a)). The Exchange Act generally defines a "broker" as any person engaged in the business of effecting transactions in securities for the account of others. Section 3(a)(4)(A) of the Exchange Act (15 U.S.C. 78c(a)(4)(A)). *See also Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934,* Exchange Act Release No. 44291 (May 11, 2001) [66 FR 27759 (May 18, 2001)], at n.124 ("Solicitation is one of the most relevant factors in determining whether a person is effecting transactions."); *Political Contributions by Certain Investment Advisers,* Investment Advisers Act Release No. 3043 (July 1, 2010) [75 FR 41018 (July 14, 2010)], n.326 ("Pay to Play Release").

“Issuer’s exemption”: Exchange Act Rule 3a4-1

- Extremely narrow, limited safe harbour with no interpretations
- For issuers that propose to market their securities by one of its “associated persons”
- This is not available for an RIA or ERA that is not an associated person
- The associated person
  - cannot be subject to a statutory disqualification
  - must have other significant duties apart from marketing
  - cannot receive commissions or other transaction-based compensation
  - cannot be an associated person with a broker or dealer at the time of the sale
- Associated persons are partners, officers, directors and employees of the issuer, the GP of a partnership of an LLP or the MD of an LLC
  - only associated persons may engage in such marketing
  - the associated person must have other substantial duties apart from marketing
  - limited class of institutional investors
  - one offering per 12 month period
- Passive sales activities – written communications or delivering PPM, responding to queries and ministerial or clerical work

“Rules of the road” for Rule 3a4-1

- Satisfy the requirements of this rule (as above)
- Keep detailed records
- Do not do indirectly something that you could not do directly
- Do not engage in a discussion of specific fund performance
- Statements must be 100% correct. Correct mistakes on the spot. Remember that the antifraud provisions of the U.S. federal securities laws apply
- Avoid communications with the media
- Be aware of and demonstrate compliance with the prohibition on “general solicitation” in Regulation D under the U.S. Securities Act of 1933 (your fund will if sold in the United States, probably use Regulation D)
- Ensure the fund is exempt from being an investment company under Sections 3(c)(1) or 3(c)(7) of the 1940 Act

Non-U.S. adviser solicits U.S. prospect to buy the securities of a non-U.S. private fund

- Under the IA-3222 interpretation, this would be brokerage
- Options:
  - if available, rely upon Rule 3a4-1
  - use Rule 15a-6 for “major U.S. institutional investors” – still requires an SEC registered broker-dealer to intermediate trades
  - get an SEC registered broker to chaperone (issue research and intermediate the trade) for “U.S. institutional investors”
  - have an SEC registered broker-dealer handle the transaction entirely for all other persons
  - register as a broker
  - avoid the U.S. markets

SEC sues four India-based brokers – November 2012

- The SEC sued four India-based brokers for engaging in brokerage with U.S. residents and not registering with the SEC as a broker, or not using Rule 15a-6

  SEC Order: Ambit Capital Pvt. Ltd.

  SEC Order: Motilal Oswal Securities Limited

  SEC Order: JM Financial Institutional Securities Private Limited

  SEC Order: Edelweiss Financial Services Limited

- Key SEC finding:
  - "Sponsored conferences in the U.S.
  - Had employees travel regularly to the U.S. to meet with investors.
  - Traded securities of India-based issuers on behalf of U.S. investors
  - Participated in securities offerings from India-based issuers to U.S. investors."
- Solicitation played a key role in these cases

SEC v Credit Suisse (2014)

- In February 2014, the SEC sued Credit Suisse Group AG for, *inter alia*, soliciting cross border brokerage (and investment advisory services) without being registered with the SEC as a broker-dealer and an investment adviser. The SEC alleged that this involved as many as 8,500 accounts, more than 100 trips to the United States to meet clients. It was also noted that while Credit Suisse did implement controls to prevent such violations (after the *UBS AG* enforcement action), it took several years before the activities ceased and Credit Suisse ceased to collect fees

In the Matter of Credit Suisse Group AG, Admin Proc 3-15763 (February 21, 2014), http://www.sec.gov/litigation/admin/2014/34-71593.pdf

In the Matter of HSBC Private Bank (Suisse) SA - 2014

- The SEC sued HSBC for, *inter alia*
  - visiting and soliciting hundreds of U.S. residents to effect transactions in securities and not registering as a broker-dealer *and*
  - visiting and giving investment advice to thousands of U.S. residents and not registering as an investment adviser
  - failing to register despite express knowledge of requirements
- HSBC admitted its wrongdoing and consented to (1) a censure (2) cease-and-desist from further violations of U.S. law and (3) payment of $12.5m in disgorgement

In the Matter of HSBC Private Bank (Suisse), SA, Admin Proc 3-16288 (November 25, 2014), www.sec.gov/litigation/admin/2014/34-73681.pdf

Bank Leumi le-Israel B.M., Leumi Private Bank and Bank Leumi (Luxembourg) S.A – *2016*

- The SEC sued Bank Leumi entities in Luxembourg, Tel Aviv and Zurich for, from 2002 through 2013
  - visiting and soliciting hundreds of U.S. residents to effect transactions in securities and not registering as a broker-dealer *and*
  - visiting and giving investment advice to hundreds of U.S. residents and not registering as an RIA
- These firms were aware of the RIA and BD registration requirements and, despite being told that this activity was illegal and attempting to cease the activities, "violations of [the policies and procedures of these firms] and the federal securities laws continued"
- These entities admitted wrongdoing for wilful violations and consented to (1) a censure, (2) a cease-and-desist order, (3) disgorgement and (4) a fine
- This was separate from a deferred prosecution agreement with the U.S. DoJ "waiving charges that [certain Bank entities] voluntarily, intentionally, and knowingly sought to willfully aid and assist in the preparation and presentation of false income tax returns and other documents"

In the Matter of Bank Leumi le-Israel B.M., Leumi Private Bank and Bank Leumi (Luxembourg) S.A, Admin Proc 3-17631 (October 18, 2016) (https://www.sec.gov/litigation/admin/2016/34-79113.pdf)

Finders

- Finders or solicitors must be registered as a broker with the SEC
- Be aware of the *Ranieri* case (March 2013) and its implications
  - A consultant solicited investors for a fund and was paid fees for this, but never registered with the SEC as a broker
  - It was argued that the consultant did no more than make initial introductions
  - According to the SEC, the consultant went "far beyond" that

"[the finder] sent private placement memoranda, subscription documents, and due diligence materials to potential investors, and urged at least one investor to consider adjusting portfolio allocations to accommodate an investment with [the adviser]. [The finder] provided potential investors with his analysis of the strategy and performance track record for [the funds], and also provided confidential information identifying other investors and their capital commitments."

William M. Stephens, http://www.sec.gov/litigation/admin/2013/34-69090.pdf
Ranieri Partners LLC and Donald W. Phillips, http://www.sec.gov/litigation/admin/2013/34-69091.pdf

Are we in or out of the Commodity Exchange Act?

- The Dodd-Frank Act amended the definition of "commodity pool" to include any type of pooled investment vehicle that trades commodities interests
  - This includes non-security-based swaps, futures, options, options on futures, FX forwards, certain CDSs
  - Also under the CFTC's jurisdiction are broad-based security indices (10 or more component securities)
  - Shares jurisdiction with the SEC for "mixed" swaps that are interests with both swap and security-based swap components

What are CTAs and CPOs?

What is a Commodity Trading Advisor?	What is a Commodity Pool Operator?
• CTAs advise managed accounts and pooled investment vehicles, such as commodity pools • CTAs are usually the investment adviser • For a separately managed account or a single investor entity, there is only a CTA	• CPOs manage commodity pools • A CPO solicits or accepts funds, securities or property from prospective investors in the commodity pool • CPOs can make trading decisions on behalf of the pool or they can retain the services of a CTA to do so • CPO can be the adviser or the GP
...an individual or organization which, for compensation or profit, advises others as to the value of or the advisability of buying or selling futures contracts, options on futures, or retail off-exchange forex contracts. http://www.nfa.futures.org/nfa-registration/cta/index.html	*...an individual or organization which 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 contracts, options on futures, or retail off-exchange forex contracts, or to invest in another commodity.* http://www.nfa.futures.org/nfa-registration/cpo/index.HTML

Rule 4.13(a)(3) *de minimis* exemption for certain CPOs

This is available to operators of private funds that engage only in a *de minimis* level of trading commodity interests

Rule 4.13(a)(3) impose trading limits in addition to investor suitability and marketing restrictions

This exemption generally requires that a fund limit its commodity positions so that either:

- the aggregate initial margin and premiums required to establish such positions will not exceed 5% of the liquidation value of the fund's portfolio; *or*
- the aggregate net notional value of the positions does not exceed 100% of the liquidation value of the fund's portfolio

Commodity positions include many types of swaps, not "security-based swaps". An annual reaffirmation of the filing for the exemption must be made through the NFA website, with advisers reviewing the conditions for the exemption and confirming they are still eligible for it

This requirement also applies to exemptions obtained under CEA Sections 4.5 and 4.7

CTAs …

Rule 4.14(a)(8)	
Consistent with its rescission of Rule 4.13(a)(4), the CFTC amended CFTC Rule 4.14(a)(8)(i)(D), which previously allowed an exemption from CTA registration for investment advisers that provided advice to funds that rely on Regulations 4.13(a)(3) or 4.13(a)(4), by removing the reference to 4.13(a)(4)	

Rule 4.14 exemption from CTA registration

CFTC Rule 4.14 provides an exemption from CTA registration for persons that

- engage solely in certain limited forms of commodity interest trading advisory activity and/or
- are registered or, in certain cases, exempt from CFTC or SEC registration

In relevant part, Rule 4.14(a)(10) exempts persons from CTA registration that do not

- provide commodity interest trading advice to more than 15 persons in any rolling 12-month period or
- hold themselves out generally to the public as a CTA

Special rules on counting and aggregating persons

- A non-U.S. CTA only counts U.S. resident clients towards the 15 person test

Other provisions of this exempt non-U.S. advisers that advise non-U.S. private funds that have only non-U.S. resident investors

Must file a notice with the NFA to claim relief (electronic) with an annual reaffirmation

Final thoughts

- The SEC and the SEC Staff under delegated authority, and the CFTC/NFA, not counsel, have the final say on matters under their respective jurisdiction
- Brokerage:
  - According to the SEC Staff, the precedents in this area are well settled and unlikely to change in the foreseeable future
  - The SEC Staff has cautioned *not* to look for safe harbors where there are none

CompliGlobe

Mark Berman

berman@compliglobe.com

London | Hong Kong

+ 1 917 724 5758

+ 44 208 458 0152

+ 852 8124 5181

www.compliglobe.com

COMPLIGLOBE
THE WORLD'S REGULATORY ADVISER™
LONDON | HONG KONG