

Alert | Financial Regulatory & Compliance



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CFTC Further Narrows Scope of Relief Under Regulation 4.7 ‘Registration Lite’

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On Sept. 12, 2024, the Commodity Futures Trading Commission (CFTC) took **another step** toward limiting the availability and scope of relief provided by CFTC Regulation 4.7 (Reg. 4.7) under the Commodity Exchange Act, as amended (CEA). Although the changes adopted in the final rule (**Final Rule**) are less comprehensive than those the CFTC had proposed earlier in the year (Proposed Rule), they are the latest in a series paring back both the extent to which Reg. 4.7 can be invoked and the relief from certain regulatory requirements it provides.

In particular, the Final Rule doubles the minimum financial requirements for a natural person to qualify as a “qualified eligible person” (QEP). CFTC notes that the financial requirements to qualify as a QEP have not changed since Reg. 4.7 was initially adopted in August 1992, while the number of persons who satisfy these requirements has grown substantially since then due to factors such as inflation. CFTC

believes that adopting increased thresholds realigns Reg. 4.7 with the original intention of distinguishing retail investors from presumably more sophisticated market participants.

Effective 60 calendar days after the Final Rule's publication in the Federal Register, individuals must satisfy a financial requirement (Portfolio Requirement) consisting of (i) owning securities and other investments with a market value of not less than \$4 million; (ii) having on deposit within the past six months at least \$400,000 in required margin for open futures and options positions; or (iii) owning a combination of funds or property which, when expressed as percentages of the required minimum amounts and added together, equals or exceeds 100%. For example, an individual who owns half of the minimum required securities and other investments, or \$2 million, and half of the minimum required margin deposit, or \$200,000, would qualify as a QEP.

Though the Final Rule does not change the basic categories or methodology that determine QEP eligibility, it doubles the previous thresholds of \$2 million in securities and other investments or \$200,000 in required margin deposit.

The Final Rule does not adopt any of the minimum disclosure requirements contained in the Proposed Rule, including descriptions of principal risk factors, investment program, use of proceeds, custodians, fees and expenses, conflicts of interest, and targeted past performance information. But CFTC notes it was prepared to consider disclosure requirements again and may adopt disclosure obligations under Reg. 4.7 in the future.

Since its adoption, Reg. 4.7 has generally served as the CFTC counterpart to Securities and Exchange Commission Regulation D (Reg. D), adopted under the Securities Act of 1933, as amended. But unlike Reg. D, which is intended as a safe harbor from securities registration under Section 4(a)(2) of the Securities Act, Reg. 4.7 provides relief both for fund operators (commodity pool operators or CPOs) conducting securities offerings exempt from Securities Act registration, and for advisors (commodity trading advisors or CTAs) offering separately managed accounts.

Reg. 4.7 is only available for registered CPOs and CTAs, unlike other CFTC regulations, including 4.5, 4.13 and 4.14, which exempt persons from having to register as CPOs or CTAs based on certain conditions. For this reason, Reg. 4.7 is sometimes referred to colloquially as "registration lite." Reg. 4.7, which nonetheless requires CFTC registration, provides relief for CPOs and CTAs in three primary areas: (i) disclosure, (ii) reporting, and (iii) recordkeeping. Prior to adopting the Final Rule, CFTC last narrowed relief for CPOs in February 2012, when it eliminated the annual audit exemption for commodity pools operated under Reg. 4.7.

The Final Rule notes that although it is not adopting the minimum disclosure requirements set forth in the Proposed Rule, CFTC intends to evaluate regulatory alternatives to minimum disclosure requirements in the future and may adopt changes "as appropriate." CFTC's continuing interest in such possible changes is interesting in light of Reg. 4.7's existing provisions. While CPOs or CTAs operating under Reg. 4.7 are not required to furnish prospective investors or customers with a disclosure document that contains certain minimal information as set forth in CFTC Part 4 Regulations, if CPOs or CTAs do provide written materials, they must contain all disclosures necessary to make them not misleading. Given that Reg. 4.7 currently imposes a materiality requirement on disclosure materials, it is unclear whether or if requiring certain specific content disclosure in addition to this requirement would provide investors or customers with additional meaningful information.

In raising the bar to qualify as a QEP, CFTC has moved in the opposite direction of SEC. Similar to the definition of QEP, the definition of accredited investor (AI) under Reg. D had been untouched for decades.

When SEC adopted the first substantive changes to the AI definition in August 2020, SEC expanded, rather than contracted, the number of persons who qualify as AIs. In addition to leaving financial requirements unchanged, SEC broadened the AI definition to include persons it deemed qualified to evaluate potential investments by virtue of their possessing certain industry licenses or qualifications. Perhaps anticipating industry criticism over CFTC’s tightening of the Portfolio Requirement, the Final Rule notes that the Portfolio Requirement was intended from its inception to be an “additional qualification” on top of AI requirements.

The Final Rule differs from SEC’s regulatory approach toward investor qualification and continues CFTC’s narrowing of Reg. 4.7’s scope. Commodity pools and managed account programs offered under Reg. 4.7 that do not accept new participants will not be required to comply with the increased Portfolio Requirement. CPOs and CTAs that accept new investors after the Final Rule’s effective date will be required to revise their offering documents and investor qualifications to comply.

The Final Rule states that a CPO or CTA that accepted a commodity pool participation or managed account, respectively, from a person who qualified as a QEP under the former Portfolio Requirement, but who does not qualify under the Final Rule, is not required to redeem such person’s pool participation or terminate the managed account arrangement. However, the Final Rule confirms that such person is not grandfathered going forward, and consequently would be required to qualify as a QEP under the revised Portfolio Requirement for additional investment or account funding. The Final Rule also leaves open possible future regulatory changes, particularly around minimum disclosure requirements.

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