

CFTC Raises the Bar for Rule 4.7 QEP Status but Holds Off on Controversial Disclosure Requirements

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On September 12, 2024, the U.S. Commodity Futures Trading Commission (CFTC) adopted amendments to CFTC Rule 4.7,¹ which provides an exemption from certain disclosure, reporting and recordkeeping obligations for registered commodity pool operators (CPOs) and commodity trading advisors (CTAs) whose pool participants and clients, respectively, are limited to “qualified eligible persons” (QEPs), as such term is defined in the rule.

Summary of Updates to Rule 4.7

The final amendments to Rule 4.7 are a subset of those originally proposed in October 2023 (the Proposal).² As adopted, the amendments:

- double the financial thresholds of the “Portfolio Requirement” in Rule 4.7’s definition of a QEP (effective six months after the final rule is published in the Federal Register);
- codify previously issued exemptive letters that permit the distribution of monthly, rather than quarterly, account statements for 4.7 pools that operate as funds-of-funds (effective 60 days after the final rule is published in the Federal Register); and
- make certain technical changes to the organization of the rule and various cross-references in other CFTC rules.

Notably, the CFTC deferred taking action on the more controversial aspect of the Proposal, which would have required specific disclosures for pools and trading programs operated and offered by registered CPOs and CTAs relying on Rule 4.7. On this point, the CFTC stated that it plans to “take additional time to consider the concerns articulated as well as the alternatives to the proposed QEP disclosure amendments put forward by commenters.”³

¹[Commodity Pool Operators, Commodity Trading Advisors, and Commodity Pools Operated under Regulation 4.7: Updating the ‘Qualified Eligible Person’ Definition; Adding Minimum Disclosure Requirements for Pools and Trading Programs; Permitting Monthly Account Statements for Funds of Funds; Technical Amendments](#), CFTC Rel. No. 8965-24 (September 12, 2024) (Adopting Release).

²[Commodity Pool Operators, Commodity Trading Advisors, and Commodity Pools: Updating the ‘Qualified Eligible Person’ Definition; Adding Minimum Disclosure Requirements for Pools and Trading Programs; Permitting Monthly Account Statements for Funds of Funds; Technical Amendments](#), CFTC Rel. No. 70853, 88 Fed. Reg. 70852 (October 12, 2023) (Proposing Release).

³ Adopting Release at 20.

Increasing the Financial Thresholds of the Portfolio Requirement in the QEP Definition

CFTC Rule 4.7 is available to CPOs and CTAs whose pool participants and clients, respectively, are limited to QEPs. Rule 4.7(a) sets forth various categories of persons who qualify as QEPs for purposes of the rule, some of whom also need to satisfy an additional Portfolio Requirement in order to be considered a QEP and some of whom do not.⁴

Prior to the effective date of the amendments, for a person to satisfy the Portfolio Requirement, the rule required that a person must:

- A. own securities (including pool participations) of issuers not affiliated with such person and other investments with an aggregate market value of at least \$2 million (the Securities Portfolio Test);
- B. have had on deposit with a futures commission merchant, for its own account at any time during the six-month period preceding either the date of sale to that person of a pool participation in the exempt pool or the date that the person opens an exempt account with the CTA, at least \$200,000 in exchange-specified initial margin and option premiums, together with required minimum security deposit for retail forex transactions (as defined in CFTC regulations), for commodity interest transactions (the Initial Margin and Premium Test); or
- C. own a portfolio comprised of a combination of the funds or property specified in (A) and (B) above in which the sum of the funds or property includable under the Securities Portfolio Test, expressed as a percentage of the minimum amount thereunder, and the amount of futures margin and option premiums includable under the Initial Margin and Premium Test, expressed as a percentage of the minimum amount thereunder, equal at least 100%.⁵

The amendments, effective 60 days after the final rule is published in the Federal Register, will double the Securities Portfolio Test threshold from \$2 million to \$4 million and the Initial Margin and Premium Test threshold from \$200,000 to \$400,000, while maintaining the ability to meet the Portfolio Requirement through a combination of the two tests adding up to 100%.⁶

In adopting these amendments, the CFTC clarified that CPOs and CTAs that wish to continue relying on Rule 4.7 are not required to redeem pool participants or end advisory relationships with those who no longer meet the Portfolio Requirement. However, a CPO or CTA is not permitted to sell any additional pool participations or open any additional exempt accounts for any person that does not meet the new Portfolio Requirement (to the extent that such Portfolio Requirement is applicable).⁷

In adopting these amendments to Rule 4.7, the CFTC reminded CPOs and CTAs relying on the rule that they are “responsible for determining the QEP status of their prospective pool

⁴ For example, pool participants or clients who meet the definition of a “non-U.S. person” (as defined in Rule 4.7) or a “qualified purchaser” (as set forth in the Investment Company Act of 1940) do not need to satisfy the additional Portfolio Requirement. In contrast, a pool participant or client who is not a qualified purchaser but is an “accredited investor” (as set forth in Regulation D under the Securities Act of 1933) would need to satisfy the additional Portfolio Requirement. See current Rule 4.7(a)(2) and (3).

⁵ Current Rule 4.7(a)(1)(v).

⁶ New Rule 4.7(a)(5).

⁷ Adopting Release at 31.

participants or advisory clients, regardless of how such QEP meets that definition, and must retain evidence of such determinations as part of their books and records.”⁸

Permitting Monthly Account Statements for Certain 4.7 Pools Consistent with Prior Exemptive Letters

Currently, Rule 4.7 permits CPOs relying on the rule to distribute account statements “no less frequently than quarterly within 30 days after the end of the reporting period.”⁹ However, CPOs of 4.7 pools that operate as funds-of-funds have trouble complying with this requirement and have regularly requested and received exemptive relief permitting them to distribute monthly, rather than quarterly, account statements for such pools within 45 days of the month-end. The amendments to Rule 4.7 adopted on September 12 formally codify this relief, effective 60 days after the final rule is published in the Federal Register.¹⁰ CPOs seeking to rely on this provision must notify pool participants of this alternative distribution schedule in the 4.7 pool’s offering memorandum distributed to the initial investment, or upon its adoption of the alternative reporting schedule, for then-existing pool participants.¹¹

Stay Tuned: Aspects of the Proposal Not (Yet) Adopted

Notably absent from this final rulemaking were the aspects of the proposal that would have required certain minimum disclosures for 4.7 pools and trading programs operated and offered by CPOs and CTAs.¹²

In deciding to defer action on this portion of the Proposal, the CFTC acknowledged certain concerns raised by commenters, including concerns that the proposed disclosure requirements would be unduly burdensome, costly and unnecessary, and would “essentially render the entire 4.7 regime, and the exemptions provided thereunder, moot.”¹³ The CFTC also acknowledged comments pointing out that the proposed disclosure requirements would create conflicts and duplicative burdens for CPOs and CTAs that are also registered as investment advisers with the U.S. Securities and Exchange Commission.¹⁴ The CFTC also acknowledged that the National Futures Association had cautioned against the proposed disclosure requirements.¹⁵

In deferring action on this aspect of the Proposal, the CFTC stated that it is “continuing to consider the remaining proposed amendments and alternative approaches offered by

⁸ Adopting Release at 32.

⁹ Current Rule 4.7(b)(3)(i).

¹⁰ New Rule 4.7(b)(3)(iv).

¹¹ Id.

¹² The Proposal would have required CPOs relying on Rule 4.7 to provide pool participants with disclosures about (i) principal risk factors, (ii) investment program, (iii) use of proceeds, (iv) custodians, (v) fees and expenses, (vi) conflicts of interest; and (vii) targeted past performance information. Similarly, the Proposal would have required CTAs relying on Rule 4.7 to provide clients with disclosures about (i) the trading program, (ii) certain persons to be identified, (iii) principal risk factors for the CTA’s trading program, (iv) fees, (v) conflicts of interest; and (vi) targeted past performance information. See Proposing Release.

¹³ Adopting Release at 14-15.

¹⁴ Id at 17.

¹⁵ Id at 15.

commenters.”¹⁶ Alternatives highlighted by the CFTC in the Adopting Release included suggestions to:

- Allow the substance of disclosures to QEP investors to be determined at the discretion of the CPO or CTA;
- Limit required disclosures to risk factors, CTA trading programs, fees and conflicts of interest, and require those disclosures to be provided only to clients who are (a) natural persons and (b) legal organizations that are not eligible contract participants;
- Permit substituted compliance (e.g., via disclosure in a CTA’s Form ADV Part 2 brochure);
- Limit the disclosure requirements such that they would not apply with respect to QEPs who qualify without the need to satisfy the Portfolio Requirement; and/or
- Limit the disclosure requirements such that they would only apply to Rule 4.7 CTA clients that are natural persons who are residents of the United States.¹⁷

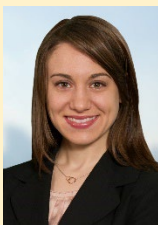
Next Steps for CPOs and CTAs

In light of the updates to the Portfolio Requirement, CPOs and CTAs that intend to continue to rely on Rule 4.7 may need to update the wording of representations that they receive from investors in their account opening/subscription documents. With respect to existing investors in 4.7 pools or accounts, CPOs and CTAs should also consider the bring-down representations that they receive in connection with additional investments or new account openings. To the extent that an investor’s original representations regarding QEP status related to the lower Portfolio Requirement thresholds, new representations may be required.

¹⁶ Id at 7.

¹⁷ Id at 19-20.

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