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I. Background

A. Statutory and Regulatory Authorities

Section 1a(5) of the Commodity Exchange Act (Act) defines the term "commodity pool operator" to mean:

[A]ny person engaged in a business that is of the nature of an investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in any commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility. * * *.¹

Section 4m(1) of the Act² provides, in relevant part, that it is unlawful for any CPO, "unless registered under [the] Act, to make use of the mails or any means or instrumentality of interstate commerce" in connection with its business as a CPO. Thus, except for the narrow exceptions currently provided in Rules 4.5 and 4.13, the operator of a collective investment vehicle that trades commodity interest contracts, whether for *bona fide* hedging purposes³ or

otherwise, must be registered with the CFTC as a CPO.⁴

Section 1a(6)(A) of the Act defines the term "commodity trading advisor" to mean any person who:

(i) For compensation or profit, engages in the business of advising others, either directly or through publications, writings or electronic media, as to the value or the advisability of trading in—

(I) Any contract of sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market or derivatives transaction execution facility;

(II) Any commodity option authorized under section 4c; or

(III) Any leverage transaction authorized under section 19; or

(ii) For compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the activities referred to in clause (i).⁵

Section 1a(6) also excludes certain persons not at issue here from the CTA definition, and provides the Commission with authority to exclude additional persons from that definition. Section 4m(1) of the Act also requires CTAs to register as such with the Commission and, along with Section 4m(3) and Rule 4.14, provides exemption from CTA registration.⁶

If a person is exempt from registration as a CPO or CTA, its associated persons (APs) are not required to register as such. Further, neither the exempt CPO or CTA, nor any of its APs, is required to become a member of a registered futures association.

Generally, CPOs and CTAs who are, or who are required to be, registered with the Commission, must provide prospective pool participants or advisory clients, as the case may be, with a Disclosure Document containing specified information⁷—e.g., the business background of the CPO or CTA and its principals, past performance, fees and other expenses, and conflicts of interest—and they must make and keep specified books and records.⁸ These CPOs also must provide unaudited periodic financial reports and certified

annual reports to participants in their pools.⁹ Additionally, regardless of registration status, all persons who come within the CPO or CTA definition are subject to certain operational¹⁰ and advertising requirements¹¹ under Part 4, to all other provisions of the Act and the Commission's rules prohibiting fraud that apply to CPOs and CTAs, and to all other relevant provisions of the Act and the Commission's rules that apply to all commodity interest market participants, such as the prohibitions on manipulation and the trade reporting requirements.

B. The Prior Rule 4.5 Proposal

Rule 4.5 makes available to certain persons (eligible persons) an exclusion from the definition of CPO with respect to their operation of certain entities (qualifying entities) that would otherwise be treated as commodity pools under the Act, but that are already subject to extensive operating requirements of another federal or state regulator.¹² These eligible persons and their qualifying entities include: (1) Investment companies registered as such under the Investment Company Act of 1940 (ICA); (2) state-regulated insurance companies with respect to their operation of insurance company separate accounts; (3) state- or federally-regulated financial depository institutions with respect to their operation of separate units of investment; and (4) trustees, named fiduciaries and certain designated fiduciaries of or employers maintaining pension plans subject to Title I of the Employee Retirement Income Security Act of 1974 with respect to the operation of such plans.¹³ In order to claim exclusion from the CPO definition under Rule 4.5, an eligible person must file a Notice of Eligibility with the National Futures Association (NFA)¹⁴ and the Commission.¹⁵ The Notice must

⁹ Rule 4.22

¹⁰ Rule 4.20 for CPOs and Rule 4.30 for CTAs.

¹¹ Rule 4.41.

While Rules 4.7 and 4.12(b) provide relief for certain registered CPOs from the Disclosure Document, periodic and annual reporting, and recordkeeping requirements of Rules 4.21, 4.22, and 4.23, they do not affect the applicability of Rules 4.20 and 4.41 to these CPOs. Similarly, CTAs who have claimed relief under Rule 4.7 continue to remain subject to Rules 4.30a and 4.41.

¹² See, generally, 50 FR 15868 (Apr. 23, 1985) for background information on Rule 4.5.

¹³ Rules 4.5(a) and (b).

¹⁴ NFA is a futures association registered as such with the Commission under section 17 of the Act, 7 U.S.C. 21 (2000).

¹⁵ Rule 4.5(c).

Additionally, Rule 4.5 provides that certain pension plans are not commodity pools. Because this exclusion is self-executing, no notice must be

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¹ 7 U.S.C. 1a(g) (2000). Section 1a(5) also provides the Commission with authority to exclude persons from the CPO definition.

Commission Rule 4.10(d)(1) correspondingly defines the term "pool" to mean "any investment trust, syndicate or similar form of enterprise operated for the purpose of trading commodity interests." Unless otherwise noted, Commission rules cited to herein are found at 17 CFR Ch. I (2000). Both the Act and the Commission's rules issued thereunder can be accessed through the Commission's Web site: <http://www.cftc.gov/cftc/cftclawreg.htm>.

CFTC Staff Letters from 1995 on can be accessed through the Commission's Web site <http://www.cftc.gov/opaletters.htm>.

² 7 U.S.C. 6m(1) (2000).

³ The Commission's definition of *bona fide* hedging is set forth in Rule 1.3(z).

⁴ Rule 4.5 provides an exclusion from the CPO definition for certain otherwise regulated "eligible persons" with respect to their operation of certain "qualifying entities," as those terms are defined in the rule, so long as they restrict the extent of their non-hedging activity in commodity interests as prescribed by the rule. As is discussed below, the Commission proposed to amend Rule 4.5, and by this *Federal Register* release is proposing further amendment of Rule 4.5.

Rule 4.13 provides an exemption from CPO registration for the operators of essentially "family, club or small pools," as those pools are described in the rule. See 44 FR 1918, 1919 (Jan. 8, 1979). As is discussed below, the Commission also is proposing to amend Rule 4.13.

⁵ 7 U.S.C. 1a(6)(A) (2000).

⁶ As is discussed below, the Commission similarly is also proposing to amend Rule 4.14.

⁷ Rule 4.21 for CPOs and Rule 4.31 for CTAs.

⁸ Rule 4.23 for CPOs and Rule 4.33 for CTAs.