

contain specified representations about how the person will operate the qualifying entity, including, as is discussed below, a requirement to restrict the amount of the entity's commodity interest trading with respect to its non-hedging activity.

Based upon its staff's experience in administering Rule 4.5, the Commission has made various revisions to the rule subsequent to the rule's initial adoption. These revisions have expanded the range of persons eligible to claim relief under the rule<sup>16</sup> and the trading strategies that may be undertaken in accordance with the rule.<sup>17</sup> Based upon staff's most recent experience with Rule 4.5, the Commission published for public comment a proposed revision to the non-hedge operating criteria and, in connection therewith, the Commission issued temporary no-action relief (Prior Rule 4.5 Proposal).<sup>18</sup> Based upon further consideration, and in connection with the CPO registration exemptions it is proposing below, by this **Federal Register** release the Commission is withdrawing the Prior Rule 4.5 Proposal and, in lieu thereof, is proposing another amendment to Rule 4.5. Pending the conclusion of the instant rulemaking, the no-action position the Commission issued in connection with the Prior Rule 4.5 Proposal will, subject to clarification as discussed below in Section IV of this release, remain in effect.

### C. The Advance Notice of Proposed Rulemaking (ANPR)

To address certain market developments and changed circumstances applicable to persons who do not qualify for an exclusion from the CPO definition under Rule 4.5 or an exemption from CPO or CTA registration under the existing statutory and regulatory framework, the Commission issued the ANPR.<sup>19</sup> As the Commission stated:

filed to claim it. Accordingly, the amendment to Rule 4.5(c) that the Commission is today proposing does not apply to these plans or their operation. See Rule 4.5(a)(4)(i)-(iv).

<sup>16</sup> See 58 FR 43791 (Aug. 18, 1993). The Commission also has expanded the class of persons who are "non-pools" under Rule 4.5. See 65 FR 24127 (Apr. 25, 2000).

<sup>17</sup> See 58 FR (Jan. 28, 1993). The original limitation of the rule encompassed all commodity interest trading. Currently, unlimited hedging may be engaged in under the rule, while non-hedging activity remains limited.

<sup>18</sup> 67 FR 65743 (Oct. 28, 2002). Both the Prior Rule 4.5 Proposal and the comment letters the Commission received thereon may be accessed through <http://www.cftc.gov/foia/fedreg02/foia.fedreg02.htm#SECTIONA>.

<sup>19</sup> 67 FR 68785 (Nov. 13, 2002). Both the ANPR and the comment letters the Commission received thereon may be accessed through: <http://>

When the Commission adopted Rule 4.13, there were fewer than a dozen designated commodity interest contracts based on stock indices, interest rates or other financial instruments. Since 1979, however, the Commission has designated, and trading has commenced in, more than 180 commodity interest contracts based on various financial instruments. These contracts frequently have attracted the interest of operators of collective investment vehicles, some of whom have registered with the Commission as CPOs so that they can use commodity interest contracts in their investment and risk management strategies. Others, however, have avoided participation in the commodity interest markets. While Rules 4.5 and 4.13 do provide CPO registration relief, their criteria are too restrictive for many operators of collective investment vehicles to meet.

Over time, persons who traditionally gave advice to collective investment vehicles solely on securities trading have become interested in providing trading advice to collective investment vehicles on commodity interest contracts based on various financial instruments as well. Absent the availability of an exemption, these persons have had to either register with the Commission as CTAs or refrain from providing any such commodity interest advice. 67 FR 68785, 68786.

By the ANPR, the Commission published for public comment two proposals it had received that would provide additional exemptions from CPO registration (one of these also would provide an additional exemption from CTA registration). These proposals were submitted by NFA and the Managed Funds Association (MFA).<sup>20</sup> NFA proposed: (1) An exemption from CPO registration where the operator restricts its pool's non-hedge commodity interest positions to a limited amount of pool assets (*i.e.*, it may commit no more than 5 percent of the pool's liquidation value to establish such positions), and restricts its pool's participants to "accredited investors" as defined in Rule 501(a)<sup>21</sup> under the Securities Act of 1933 (Securities Act);<sup>22</sup> and (2) an exemption from CTA registration for those persons that advise pools operated by CPOs that have claimed either an exemption from registration under the proposed NFA rule or an exclusion from the CPO definition under Rule 4.5 (NFA Proposal). MFA proposed an exemption from CPO registration for pool operators that restrict participation in their pools to certain "qualified eligible persons" (QEPs) as defined in Rule 4.7 and

[www.cftc.gov/foia/fedreg02/foia.fedreg02.htm#SECTIONA](http://www.cftc.gov/foia/fedreg02/foia.fedreg02.htm#SECTIONA).

<sup>20</sup> MFA is a non-profit membership organization for investment professionals in the hedge fund, futures and alternative investments industries.

<sup>21</sup> 17 CFR 230.501(a)(2002).

<sup>22</sup> 15 U.S.C. 77a *et seq.* (2002).

certain "accredited investors" (MFA Proposal). By the ANPR the Commission also issued temporary registration no-action relief for certain CPOs and CTAs.<sup>23</sup>

Based upon the comments received on the ANPR,<sup>24</sup> and as a result of its own further consideration, the Commission is proposing herein CPO and CTA registration exemptions based on the NFA and MFA Proposals. Pending the conclusion of this rulemaking, the CPO and CTA registration no-action relief that the Commission issued in connection with its publication of the ANPR will, subject to modification and clarification as discussed below, remain in effect.

### D. Roundtable on CPO and CTA Issues (Roundtable)

Section 125 of the Commodity Futures Modernization Act of 2000 (CFMA)<sup>25</sup> required the Commission to "conduct a study of the [Act] and the Commission's rules, regulations and orders governing the conduct of persons required to be registered under the Act." Pursuant to this directive, the Commission conducted such a study, and in June 2002, issued its findings in a "Report on the Study of the Commodity Exchange Act and the Commission's Rules and Orders Governing the Conduct of Registrants under the Act (Report)."<sup>26</sup> In September 2002, the Commission held a "Roundtable on CPO and CTA Issues" to address, among others, issues identified in the Report relating to overlapping regulatory jurisdiction faced by members of the managed funds industry.<sup>27</sup> As a result of the testimony provided at the Roundtable, and also based on prior staff activity in this area, by this **Federal Register** release the Commission is proposing additional regulatory relief for CPOs and CTAs. This relief would: (1) Permit certain communications by CPOs and CTAs with prospective and existing pool participants and advisory clients prior to Disclosure Document distribution; (2) relieve CPOs from duplicative disclosure and reporting requirements in the "master/feeder fund" context; (3) establish criteria for CPOs to distribute

<sup>23</sup> See 67 FR 68786, 68788-89.

<sup>24</sup> Section II of the **Federal Register** release discusses the comments the Commission received on the ANPR, as well as the comments the Commission received on the Prior Rule 4.5 Proposal.

<sup>25</sup> Pub. L. No. 106-554, Appendix E, § 125, 114 Stat. 2763A-365 (2000).

<sup>26</sup> The Report may be accessed through <http://www.cftc.gov/files/opa/opaintermmediarystudy.pdf>.

<sup>27</sup> Comments received in connection with the Roundtable may be accessed through <http://www.cftc.gov/opa/press02/opa4700-02.htm>.