

and entities may not need to be subject to any commodity interest trading criteria to qualify for relief under Rule 4.5. The Commission further believes that the absence of such criteria may render obsolete the current disclosure requirement in Rule 4.5(c)(2)(iii).

Accordingly, the Commission is proposing to delete paragraphs (c)(2)(i) and (c)(2)(iii) from Rule 4.5. This would result in paragraphs (c)(2)(ii) and (c)(2)(iv) of the rule, which concern the other representations that the Notice of Eligibility must contain, being redesignated as paragraphs (c)(2)(i) and (c)(2)(ii), respectively. Thus, the Rule 4.5 operating criteria would continue to include: (1) A prohibition against marketing a qualifying entity as a commodity pool or otherwise as a vehicle to trade commodity interests; and (2) a requirement to submit to special calls to demonstrate compliance with eligibility for relief under Rule 4.5. The Commission believes it is appropriate to maintain the marketing restriction because, unlike the case with the proposed CPO registration exemption, members of the retail public may participate in the trading vehicles subject to Rule 4.5. The Commission nonetheless requests comment on the merits of maintaining current Rule 4.5(c)(2)(ii) (which would be redesignated as Rule 4.5(c)(2)(i)).

#### *B. Proposed Amendments to Rule 4.13: Expanding and Adding CPO Registration Exemptions*

##### **1. Proposed Amendments to Rule 4.13(a)(2): Expanding the Current Exemption**

Rule 4.13(a)(2) currently provides that a person is exempt from registration as a CPO if:

(2)(i) The total gross capital contributions it receives for units of participation in all of the pools that it operates or that it intends to operate do not in the aggregate exceed \$200,000; and

(ii) None of the pools operated by it has more than 15 participants at any time. For purposes of computing the number of participants for paragraph (a)(2)(ii) of this section, the following participants shall be excluded:

(A) The pool's operator, commodity trading advisor, and the principals thereof; and

(B) Any relative, spouse or relative of such spouse living in the same household as such participant.

The Commission adopted the exemptive criteria of Rule 4.13(a)(2) in 1981.<sup>33</sup> In light of the rate of inflation in the more than twenty years since that time and Commission staff's experience in administering Rule 4.13(a)(2), the

Commission is proposing various amendments that will update and clarify the rule, making it available to more persons.

First, the Commission is proposing to increase the total of the gross capital contributions criterion under Rule 4.13(a)(2) to \$400,000 from \$200,000.<sup>34</sup> This proposed amount (\$400,000) reflects adjustments to the current amount (\$200,000) based on the Consumer Price Index published by the Bureau of Labor Statistics of the United States Department of Labor.<sup>35</sup>

Second, the Commission is proposing to expand the range of participants excluded from the "no more than 15 participants" limitation of the rule and to clarify that the contributions of these participants do not count toward the capital contributions limit of the rule.<sup>36</sup> This clarification would require a reorganization of Rule 4.13(a)(2) such that, as proposed, the rule would provide that a person is exempt from CPO registration if:

(2)(i) None of the pools operated by it has more than 15 participants at any time; and

(ii) The total gross capital contributions it receives for units of participation in all of the pools it operates or that it intends to operate do not in the aggregate exceed \$400,000.

(iii) For the purposes of determining eligibility for exemption under paragraph

<sup>34</sup> One of the commenters on the ANPR suggested a similar increase.

<sup>35</sup> See <http://data.bls.gov/cgi-bin/cpicalc.pl>, where the "CPI Inflation Calculator" made available on that page (for values less than \$10,000) determines that \$2,000 in 1981 has the same buying power as \$3958.20 in 2002.

<sup>36</sup> See CFTC Staff Letter 99-41 (Aug. 27, 1999), where, in permitting a CPO to exclude the contributions of itself and its spouse in determining whether the contribution limit (of \$200,000) of Rule 4.13(a)(2) has been met, Commission staff explained:

Paragraph (a)(2)(i) of Rule 4.13 does not address whether the gross capital contributions to a pool by its operator or advisor should be excluded from the \$200,000 limit in the rule, even though a pool's operator, advisor, and the principals thereof specifically are excluded from the "no more than fifteen participants" limit in paragraph (a)(2)(ii) of the rule. That paragraph provides that for the purposes of computing the number of participants allowable in a pool for which the operator thereof seeks to claim an exemption from registration under Rule 4.13(a)(2), the pool's operator, advisor and their principals are excluded. This provision was patterned after Rule 501(e)(1)(i) under the Securities Act of 1933 ("the '33 Act"), which provides that for the purposes of computing the number of non-accredited purchasers allowed to participate in an exempt offering under Rule 506 under the '33 Act, "the following purchasers shall be excluded: any relative, spouse or relative of the spouse of a purchaser who has the same principal residence as the purchaser." Since Rule 506 provides an exemption from the registration of securities otherwise required under the '33 Act for limited offers and sales without regard to the dollar amount of the offering, the exemptive rules under the '33 Act need not, and do not, make any mention of excluding the capital contributions of persons who are excluded from the computation of non-accredited purchasers. (Footnotes omitted).

(a)(2) of this section, the person may exclude the following participants and their contributions:

(A) The pool's operator, commodity trading advisor, and the principals thereof;

(B) A child, sibling or parent of any of these persons;

(C) The spouse of any person specified in paragraph (a)(2)(iii)(A) or (B) of this section; and

(D) Any relative of a person specified in paragraph (a)(2)(iii)(A), (B) or (C) of this section, its spouse or a relative of its spouse, who has the same principal residence as such person.

##### **2. Proposed Rule 4.13(a)(3): Adding a Limited Trading Exemption**

Proposed Rule 4.13(a)(3) is based on the NFA Proposal and also on the Commission's Prior Rule 4.5 Proposal. It would provide an exemption from CPO registration where the pool a person operates engages in a limited amount of commodity interest trading—*i.e.*, by committing a limited amount of the liquidation value of the pool's portfolio to establish commodity interest trading positions, whether entered into for *bona fide* hedging purposes or otherwise, or where the aggregate net notional value of the pool's commodity interest trading does not exceed fifty percent of the pool's liquidation value. The Commission's proposal does, however, differ from the NFA Proposal in certain respects. It would limit the amount that could be committed to establish commodity interest positions to two percent of the liquidation value of a pool's portfolio, whereas the NFA Proposal would establish a five percent limit. The Commission believes that the lower amount it is proposing may be more appropriate than the NFA amount because it is closer to the "*de minimis*" level of commodity interest trading that the rule is intended to encompass, and, further, because the level of investor qualification proposed under the rule—*i.e.*, that of an "accredited investor"—is not a particularly high threshold to meet.<sup>37</sup> Moreover, the rule would provide, through its alternative test, another means for CPOs to come within

<sup>37</sup> Rule 501(a) under the Securities Act defines a natural person "accredited investor" as:

(5) Any natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase exceeds \$1,000,000; [or]

(6) Any natural person who had an individual income in excess of \$200,000 in each of the two most recent years or joint income with that person's spouse in excess of \$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year.

The chart below illustrates that a significant number of commodity interest contracts could be established under the proposed "Two Percent Test."

<sup>33</sup> See 46 FR 26004, 26006 (May 8, 1981).