

Investment Management Alert

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CFTC and NFA Year End Regulatory Updates

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Key Points

- Effective January 1, 2020, clarifying amendments to rules regarding communications with the public and use of promotional material will go into effect.
- Effective February 1, 2020, CTA will be subject to new limitations on including accounts with constant nominal size and accounts traded differently in composite performance and new requirements for written confirmations for clients with nominal account size.
- On November 25, 2019, amendments exempting certain CPOs meeting the definitions of “Family Office” or “Business Development Corporations” and exempting certain CTAs and CPOs from certain registration requirements were approved.

NFA Compliance Rules 2-29

The National Futures Association (NFA) adopted amendments to its Compliance Rules 2-29 and related Interpretive Notices relating to promotional materials (the “NFA Advertising Rules”). The NFA Advertising Rule establishes requirements for an NFA member’s communications with the public and use of promotional material. These amendments (i) narrow the NFA Advertising Rule’s application to only commodity pool operators (CPOs), commodity trading advisors (CTAs), futures commission merchants and introducing brokers; (ii) better reflect current technology and business practices; (iii) clarify that all performance must be net of all commissions, fees and expenses; and (iv) modify the exemption regarding the permitted use of hypothetical performance in promotional material by CTA and CPO Members operating pursuant to a U.S. Commodity Futures Trading Commission (CFTC) Regulation 4.7 exemption. These amendments will become effective on January 1, 2020. Once effective, these amendments will require the restatement of performance prior to January 1, 2020 if presented after the effective date.

The amendments to NFA Advertising Rule effect the following changes:

- **Scope.** Instead of only covering futures-related activities, the NFA Advertising Rule now applies to all “commodity interest” activities, which includes swaps¹.

Contact Information

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- **Electronic Communications.** Promotional material now includes communications disseminated through electronic means.
- **Net Performance.** Performance must be presented net of all commissions, fees and expenses.
- **Hypothetical Performance.** NFA has modified the available relief to CTA and CPO Members operating pursuant to CFTC Regulation 4.7 to require those Members to generally comply with the NFA Advertising Rule's hypothetical performance disclaimer requirements, but permits marketing materials aimed exclusively at qualified eligible persons to depart from certain specific disclosure requirements related to extracted performance and composite performance².
- **Member Submissions.** Members must now submit to NFA for review and approval all forms of audio and visual promotional material that make specific trade recommendations or discuss profit achieved in the past or that can be achieved in the future.

NFA Compliance Rule 2-34

The adopted amendments to its Compliance Rule 2-34 and related Interpretive Notice relating to CTA performance reporting and disclosures (the "NFA CTA Rules") are effective February 1, 2020. The amended NFA CTA Rules will require a CTA managing a notionally funded account to receive from or deliver to its clients a confirmation of an explanation of how cash additions, withdrawals and net performance will affect nominal account size. The NFA also provided guidance that accounts included in composite performance capsules must be traded in the same manner and have a similar nominal size to be included. Finally, the amended NFA CTA Rules require that for accounts which have a constant notional value, monthly rates of return must be summed rather than compounded when calculating annual rates of return, peak-to-valley drawn-down percentage and net lifetime rate of return.

Amendments to Part 4

On November 25, 2019, the CFTC approved previously proposed amendments to Part 4 that harmonized CFTC and SEC regulations for asset managers³. The effective date for these amendments is January 9, 2020.

Family Office (Replaces Letter 12-37 and Letter 14-143)

CPOs and CTAs who meet the definition of "family office" will become exempt from registration requirements, consistent with the regulatory exclusion from the definition of "investment adviser" for Family Offices adopted by the SEC in 2012. A CPO may qualify for this exemption if: (a) interests in the pool are exempt from registration under the Securities Act of 1933 and such interests are sold only to "family clients;" (b) the commodity pool qualifies as a "family office;" and (c) the person reasonably believes, at the time of the investment, or at the time of conversion for an existing pool, that each person who participates in the pool is a "family client" of the "family office." A CTA may qualify if they direct commodity trading advice solely to, and for the sole use of, "family clients." Unlike the relief provided under CFTC Letter 12-37, the "family office" exemption set forth under regulations 4.13(a)(8) and 4.14(a)(11) will not require any filing with the CFTC or the NFA.

Business Development Companies (Replaces Letter 12-40)

Any registered investment adviser with respect to a business development company (BDC) that has elected an exemption from registration as an investment company with the SEC under the Investment Company Act of 1940 and meets the other applicable requirements will not be included in the definition of a CPO and thus exempt from CPO registration requirements. Further, this amendment clarifies that the registered investment adviser of a registered investment company is also excluded from the CPO definition (as opposed to the registered investment company itself being excluded).

Reporting Person (Replaces Letter 14-115 and Letter 15-47)

“Reporting person” now excludes certain persons who, despite qualifying for an exclusion or exemption from CPO registration under Rule 4.5 or 4.13, or an exemption from CTA registration under Rule 4.14(a)(4) or 4.14(a)(5), register nonetheless. As a result, Form CPO-PQR will not be required to be filed by any registered CPO that only operates pools for which such person is either exempt from CPO registration or excluded from the CPO definition, and Form CTA-PR will not be required to be filed by any registered CTA that either does not direct client accounts or directs only the accounts of commodity pools for which such person is registered as a CPO (and thus already is required to file Form CPO-PQR) or exempt from registration as a CPO (and thus is not required to file Form CPO-PQR).

Offshore Commodity Pool Operators

The CFTC decided not to adopt certain proposals set forth in its October 2018 Notice of Proposed Rulemaking⁴. Specifically, the CFTC decided not to adopt amendments that would provide a registration exemption for CPOs that solicit and/or accept funds from only non-U.S. persons for participation in offshore commodity pools and permit the U.S.-based CPO of an offshore commodity pool to maintain the commodity pool's original books and records at the offshore location of the pool.

¹ “Commodity interest” replaces “futures” in the definition section. “Commodity interest account, agreement or transaction” includes commodity interest accounts, transactions and orders, commodity pool participations, agreements to direct or guide trading in commodity interest accounts and agreements and transactions involving the sale, through publications or otherwise, of non-personalized trading advice concerning commodity interests. See NFA Interpretive Notice entitled *Compliance Rule 2-29: Use of Promotional Material Containing Hypoethical Performance Results*, available at <https://www.nfa.futures.org/rulebook/rules.aspx?Section=9&RuleID=9025>

² See NFA Interpretive Notice entitled *Compliance Rule 2-29: Use of Promotional Material Containing Hypoethical Performance Results*, available at <https://www.nfa.futures.org/rulebook/rules.aspx?Section=9&RuleID=9025>

³ See Akin Gump Client Alert entitled *CFTC Proposes to Codify Existing Staff-Issued Relief from Registration and Other Compliance Requirements for CPOs and CTAs*, available at <https://www.akingump.com/en/news-insights/cftc-proposes-to-codify-existing-staff-issued-relief-from.html>

⁴ See Akin Gump Client Alert entitled *CFTC Proposes to Codify Existing Staff-Issued Relief from Registration and Other Compliance Requirements for CPOs and CTAs*, available at <https://www.akingump.com/en/news-insights/cftc-proposes-to-codify-existing-staff-issued-relief-from.html>

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