

## CPO and CTA Registration Requirements for Hedge Fund Managers

### Who Needs to Register with the CFTC?

With certain limited exemptions, all individuals and organizations doing business as futures professionals must register under the Commodities Exchange Act (“CEA”). Specifically, futures professionals register with the Commodity Futures Trading Commission (“CFTC”) and apply for membership at the National Futures Association (“NFA”) through NFA’s online registration system. Depending on the individual or firm’s futures related business activity each entity or associated individual must register under one, or more, of the following categories:

- **Futures Commission Merchant;**
- **Swap Dealer;**
- **Major Swap Participant;**
- **Retail Forex Exchange Dealer;**
- **Introducing Broker:**
  - *An IB is an individual or organization which solicits or accepts orders to buy or sell futures contracts, options on futures, retail off-exchange forex contracts or swaps but does not accept money or other assets from customers to support such orders.*
- **Commodity Pool Operator (“CPO”):**
  - *An individual or organization that operates a commodity pool and solicits funds for that commodity pool. A commodity pool is an enterprise in which funds contributed by a number of persons are combined for the purpose of trading futures contracts, options on futures, retail off-exchange forex contracts or swaps, or to invest in another commodity pool.*
- **Commodity Trading Adviser (“CTA”):**
  - *An individual or organization that, for compensation or profit, advises others as to the value of or the advisability of buying or selling futures contracts, options on futures, retail off-exchange forex contracts or swaps.*
- **Associated Person:**
  - *An AP is an individual who solicits orders, customers or customer funds (or who supervises persons so engaged) on behalf of an FCM, RFED, IB, CTA or CPO. An AP is, in effect, anyone who is a salesperson or who supervises salespersons for any of these categories of individuals or firms.*
- **Principal:**
  - *An individual's status as a principal is determined by the individual's 1) ability to control a registrant's business activities; 2) formal title or position with the registrant; and 3) financial or ownership interest in the registrant. Individuals who, through their conduct or activity, directly or indirectly control a registrant are principals of the registrant, irrespective of their formal title or financial interest in the registrant. Similarly, individuals who hold specific positions or titles with registrants (see definition of principal) are also principals of the registrant, irrespective of their ability to control the registrant's business.*
- **Floor Broker;**
- **Agricultural Trade Option Merchant**

### Do managers of private funds investing in futures, options on futures or off-exchange forex need to register with the CFTC?

Yes. Unless an exemption applies, a manager advising and soliciting funds for a commodity pool must register as a CPO. If the manager also advises separately managed accounts investing in commodities CTA registration must also be obtained.

## What are the major Exemptions from registration under the CEA?

The following chart highlights the current exemptions from registration under the CEA:

### **Rule 4.13(a)(1)**

Provides relief from CPO registration if *all* of the following provisions are met:

1. Manager operates only one pool at a time;
2. Manager does not receive any form of compensation;
3. Manager does not advertise; and
4. Manager is not otherwise required to register with the NFA

### **Rule 4.13(a)(2)**

1. The manager does not operate any pools which have 15 or more investors (excluding the manager and certain related persons); *and*
2. The total gross capital contributions in all pools operated or intended to be operated by the manager do not in the aggregate exceed \$400,000 (certain capital contributions, including those of the manager, will not be counted for the purposes of this rule)

### **Rule 4.13(a)(3)**

1. The commodity pool interests are exempt from registration under the Securities Act of 1933, and such interests are offered and sold without marketing to the public in the United States;
2. All of the investors in the pool must be an accredited investors (or similar qualification as specified in the rule); *and*
3. One of the following tests is met:
  - a. The aggregate initial margin and premiums required to establish such positions, determined at the time the most recent position was established, will not exceed 5 percent of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into; *or*
  - b. The aggregate net notional value of such positions, determined at the time the most recent position was established, does not exceed 100 percent of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into.

### **Rule 4.5**

Some entities already registered with other regulatory bodies such as managers to registered mutual funds, insurance companies, banks and ERISA fiduciaries need not register as CPOs. A CPO claiming rule 4.5 exemption must file of notice of the exemption with the NFA and make certain disclosures to the investors in the pool.

### **Rule 4.7**

This rule applies to *registered* CPOs but allows such managers to avoid certain disclosure and reporting requirements under Rule 4.21, Rule 4.22(a) and (b), Rule 4.24, Rule 4.25 and Rule 4.26 with respect to each exempt pool, although the new rules require that these CPOs file certified annual reports. To claim this exemption all of the investors in the commodity pool must be qualified eligible persons which generally will mean that they are qualified purchasers. Notice of rule 4.7 exemption must be filed with the NFA.

### **Rule 4.12**

While under 4.7 there is no limitation on the amount of commodities held by the pool, rule 4.12 limits the amount of commodities held to 10% of the pools assets and requires that all commodity trading be solely incidental to securities trading activity. Also only applicable to registered CPO's, the CPO must file a notice of exemption and

adhere to certain disclosure regulations

## What does Registration involve and what costs are associated with it?

### **CPO/CTA Registration**

A **CPO/CTA** is required to *file* the following:

- A completed online Form 7-R (includes NFA membership sections)
- A non-refundable application fee of \$200.00
- CPO Membership Dues of \$750.00

A **CPO/CTA** is required to file applications for its *Principals* and *Associated Persons*

- A completed online Form 8-R
- Fingerprint cards
- Proficiency Requirements
- A non refundable Principal Application Fee of \$85.00\*
- A non refundable Associated Person Application Fee of \$85.00\*

Additionally, all registered **CPOs/CTAs** engaged in *retail off-exchange forex activities* are required to:

- Apply to become a forex firm by completing online Form 7-R
- Have at least one principal that is also an approved Forex Associated Person
- Submit payment of CPO Forex Firm membership dues of \$2,500 (or surcharge of \$1,750 if applicant is already an NFA Member)

Additionally, all registered **CPOs/CTAs** engaged in *swap transactions* are required to:

- Apply to become a swap firm by completing online Form 7-R
- Have at least one principal that is also an approved Swap Associated Person

\*An application fee is not required if the individual is currently registered with the CFTC in any capacity or is listed as a principal of a current CFTC registrant. In addition, only one application fee is required if filing as an application as both an Associated Person and Principal.

### **Associated Person (AP) Registration**

Registration is generally required *unless*:

- The individual is already registered as an FCM, IB or Floor Broker\* or
- The individual is already registered as a CPO if you are to be associated with a CPO or
- The individual is already registered as a CTA if you are to be associated with a CTA or
- The individual is already registered with the Financial Industry Regulatory Authority (FINRA) as a registered representative and limits futures activity to the solicitation of participations in a commodity pool.

\*Registered Floor Brokers who intend to solicit customer business should review their exchanges' rules to determine if there are any additional exchange requirements or limitations on their activity.

For more details on AP exemptions, please refer to CFTC Regulation [3.12\(h\)](#).



The following are *filing* requirements for an AP:

- A completed online Form 8-R
- Fingerprint Cards
- Proficiency requirements
- Verification of the Form 8-R
- A non refundable Associated Person Application Fee of \$85.00\*\*

Additionally, all registered APs engaged in retail *off-exchange forex activities* are required to:

- Satisfy Proficiency Requirements
- Be sponsored by an approved Forex Firm

### **What annual and periodic Compliance requirements does a registered CPO need comply with?**

#### **Annual Requirements**

- Complete annual NFA questionnaire
- File annual registration update
- Complete self-examination questionnaire
- Submit pool financial statements and quarterly reports and distribute to pool participants
- Send firm's privacy policy to pool participants
- Test disaster recovery plan
- Provide ethics training as outlined in firm's Ethics Training Procedures
- File exemption notices, if applicable

#### **Financial Reporting Requirements**

- CPO's are required to maintain accounting systems and prepare periodic financial statements for each pool they operate.
- CPO's report on a quarterly basis to the NFA regarding changes in the pool's net assets and its performance and file and distribute an annual financial report, certified by a independent public accountant.
- Additionally, each pool with assets over \$500,000 must distribute account statements to each participant on a monthly basis.

#### **Disclosure Documents**

Prospective investors in a commodity pool must be provided a Disclosure Document, not more than 9 months old, prepared by the CPO and approved by the NFA.

#### **Exemption Filing**

Each CPO or CTA claiming an exemption from registration under the rules above must annually file a notice identifying which exemption it is relying on.

### **What Exam requirements are associated with registration?**

Individuals applying for NFA membership as a sole proprietor FCM, RFED, IB, CPO, CTA, or for registration as an AP of these categories, must satisfy proficiency requirements. Unless they are eligible for the *alternatives*, they



must have passed the National Commodity Futures Examination (NCFE or **Series 3**) within the two years preceding their application.

### **Alternatives to Series 3**

Based on an individual's registration status and the type of business they conduct they may be eligible to one or more of the following alternatives to Series 3 examination:

**Futures Managed Funds Examination (Series 31)** Available if:

- the individual is registered with FINRA as a General Securities Representative with a FINRA member firm, and
- that FINRA member firm is also an NFA FCM or IB member firm or an applicant for NFA FCM or IB membership and is sponsoring the individual for AP registration, and
- the individual is going to limit futures activities on behalf of that NFA/FINRA sponsoring firm to soliciting funds, securities or property for participation in a commodity pool, soliciting discretionary accounts to be managed by CTAs or supervising persons who perform these same limited activities.

**Limited Futures Examination (Series 32)** Available to an individual who has, within the two years prior to filing the application:

- been registered or licensed to solicit customer business in futures in a jurisdiction outside of the United States (currently UK and Canada only).
- in order to be eligible for this alternative exam, applicants must submit proof of such registration or license to NFA.
- additional information or documentation relating to an applicant's market knowledge may also be required.

**Referral of Securities' Clients.** Available if:

- is registered with FINRA as a General Securities Representative with a FINRA member firm, and
- that FINRA member firm is also an NFA FCM or IB member firm or an applicant for NFA FCM or IB membership and is sponsoring the individual for AP registration, and
- the individual is going to limit futures activity on behalf of that sponsor to referring clients to APs of that sponsor, which referrals are solely incidental to the individual's business as a General Securities Representative of that sponsor.

### **Retail Off-Exchange Forex Examination (Series 34)**

An individual seeking approval as a forex firm or forex individual must pass the **Series 34** examination before engaging in off-exchange forex business with retail customers.

The amendments provide that any individual applying for approval as a forex firm or forex individual shall not be granted approval as a forex firm or forex individual unless:

- the applicant has satisfied the **Series 3** or **Series 32** proficiency requirement (as described above) and
- NFA has received satisfactory evidence that the applicant has passed the **Series 34** within two years of the date the application is filed or
- since the date the applicant last passed the **Series 34** there has been no period of two consecutive years during which the applicant has not been either registered as an AP or FB or an approved principal of a registrant; or
- the applicant was registered as an AP, FB or an approved sole proprietor on May 22, 2008, and there has been no period of two consecutive years since that date during which the applicant has not been either registered as an AP or FB or an approved principal of a registrant.