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US Commodity Pool and Commodity Pool Operator Regulation

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Agenda

1. What law governs commodity pools and commodity pool operators (“CPOs”)?
2. Who regulates CPOs?
3. What is a commodity pool and when do CPO status questions arise?
4. How are CPOs regulated?
5. What exclusions and exemptions apply to CPOs?
6. What CPO regulatory changes have occurred recently?
7. What is the enforcement environment for CPOs?



What laws govern CPOs?

The Commodity Exchange Act

- The Commodity Exchange Act (“CEA” or “Act”) is the 1936 successor to the Grain Futures Act of 1922
- In 1974, the CEA’s scope was radically increased to cover nearly all futures contracts through an amendment to the definition of the term “commodity”
 - The futures exchanges had expanded beyond contracts with agricultural commodities as underlyings and were beginning to trade non-agricultural commodities (e.g., foreign currency)
 - Rather than continue the ad hoc process of amending the Act to add new commodities, Congress amended the commodity definition to cover nearly all commodities
- The CEA is codified at Title 7 of the United States Code (note that section numbers of the United States Code do not always match those in the CEA*.)
- The CEA was substantially amended in 2010 by the Dodd-Frank Act

* A conversion chart is available at www.cftc.gov/LawRegulation/ceaconvchart.html



Who regulates CPOs and CTAs?

US Derivatives Regulators

- **Commodity Futures Trading Commission (CFTC)**
 - Administers and enforces the CEA
- **Futures Exchanges**
 - Administers and enforces exchange rules
- **National Futures Association (NFA)**
 - Administers and enforces its rules / examines CFTC registrants
- **US Attorney's Office / Department of Justice**
 - Criminal authority
 - Any "willful" conduct may be subject to criminal prosecution

Role of the CFTC

- Oversees derivatives markets and promulgates rules to regulate the industry
 - Rules under the CEA are codified in Title 17 of the Code of Federal Regulations
- Brings civil enforcement actions to enforce the rules:
 - Enforcement actions usually triggered by a Division of Enforcement investigation
 - CFTC votes on whether to bring an enforcement case
 - Enforcement cases are prosecuted by Division of Enforcement
 - Either brought before an Administrative Law Judge (“ALJ”) (this is rare, as CFTC needs to borrow ALJs from other agencies) or federal district court (more common)

CFTC Jurisdiction

- Regulates the activities of market participants, which include CPOs and CTAs
 - To determine whether the CFTC has jurisdiction over a commodity interest transaction under the CEA, we generally examine two factors:
 - Whether the transaction involves a “commodity interest,” and
 - The location of the parties to, and the execution of, the transaction.
 - “Commodity interests”: Futures, options on futures, swaps and retail commodity transactions (among others).
 - Non-commodity interests: spot transactions, forward contracts, physically-delivered FX swaps and FX forwards, securities, security-based swaps and listed equity option contracts (among others).
 - But, the CFTC has anti-fraud and anti-manipulation authority with respect to cash (physical) commodity transactions (such as Bitcoins and crude oil).

Role of the NFA and Jurisdiction

- National Futures Association (“NFA”) is the only registered futures association
- NFA is a self-regulatory organization, similar to FINRA for the securities industry, of which many CFTC registrants are required to be members
- The NFA is run by the members themselves through full-time staff, subject to CFTC oversight
- CFTC has delegated most registration functions to the NFA; if a potential registrant wants to become registered, their primary interaction is with the NFA
- In addition, NFA issues rules and enforces them against its members, conducts audits of member firms, etc.
- NFA enforcement actions may be appealed to the CFTC and subsequently to the courts of appeals

Roles of the Exchanges and Jurisdiction

- CPOs and CTAs are subject to the rules on the exchanges, on which they place orders
- Deemed Consent
 - CME Rule 418 and ICE Rule 4.00 provide that any person “initiating or executing a Transaction on or subject to the Rules of the Exchange directly or through an intermediary . . . expressly consents to the jurisdiction of the Exchange and agrees to be bound by and comply with the Rules of the Exchange,” including rules requiring cooperation and participation in investigatory and disciplinary processes.
- Remedy for Non-Cooperation
 - Rule violation and termination of market access and possible referral to the CFTC



What is a commodity pool, and when do CPO and CTA status questions arise?

Commodity Pool Defined

- The CFTC considers any “investment trust, syndicate or similar form of enterprise” that trades or enters into any commodity interest contract to be a commodity pool.
 - The CFTC has generally interpreted the term “commodity pool” to include any pooled vehicle that holds a single swap for any reason. *See* 77 Fed. Reg., 11,252, 11,263 (Feb. 24, 2012) (“As a result, one swap contract would be enough to trigger the registration requirement.”).
- In addition, the CFTC, by rule, may include within, or exclude from, the term “commodity pool” any investment trust, syndicate, or similar form of enterprise if the CFTC determines that the rule or regulation will effectuate the purposes of the CEA.
- Commodity pools are not required to register under the CEA. Rather, the CPO of a commodity pool registers with the CFTC, while the pool is listed under the CPO’s registration.

CPO Defined

- A CPO is any person engaged in the business of a commodity pool who, in connection therewith, solicits, accepts, or receives from others, funds, securities or property for the purpose of trading in commodity interests. See CEA §1a(11).
- Under CEA §4m(1), CPOs are required to register with the CFTC, absent an exclusion or exemption.
- The CFTC has the authority to include within, or exclude from, the CPO definition any person if such inclusion or exclusion will effectuate the purposes of the CEA.

Who is the CPO?

- The CFTC has indicated that the following factors are relevant for determining who is acting as a CPO:
 - Who is *promoting* the pool by soliciting, accepting or receiving from others, funds or property for the purpose of commodity interest trading
 - Who has the *authority to hire* (and to fire) the pool's adviser
 - Who has the *authority to select* (and to change) the futures commission merchant (broker)
- In the fund context, the CPO is often the general partner of a limited partnership, the managing member or manager of a limited liability company, the trustees of a trust, or the directors of a corporation.

CTA Defined

- CPOs often also act as CTAs, such as when the CPO serves as the investment manager to a fund that the CPO has organized.
- CEA §1a(12) broadly defines a CTA as any person who, for compensation or profit, directly or indirectly advises others as to the value or advisability of trading in commodity interests, or regularly issues or promulgates analyses or reports concerning commodity instruments.
- The definition of CTA also generally includes persons who *select* CTAs to manage accounts.
- CTAs are generally required to register with the CFTC, subject to a number of exemptions.

CTA Exclusions

- The CTA definition specifically excludes the following if the commodity advice is “solely incidental to the conduct of their business or profession”:
 - Any bank or trust company or any person acting as an employee thereof;
 - Any news reporter, news columnist, or news editor of the print or electronic media, or any lawyer, accountant, or teacher;
 - Any floor broker or futures commission merchant;
 - The publisher or producer of any print or electronic data of general and regular dissemination, including its employees;
 - The fiduciary of any defined benefit plan that is subject to the Employee Retirement Income Security Act of 1974 (29 USC. 1001 et seq.);
 - Any contract market or derivatives transaction execution facility; and
 - Such other persons not within the intent of this paragraph as the CFTC may specify by rule, regulation, or order

CTA Exemptions

A host of exemptions from registration may apply, including:

1. **CEA §4m(1) / CFTC Rule 4.14(a)(10):** Small advisors (15 or fewer clients and no holding)
2. **CEA §4m(3):** SEC-registered investment advisers
3. **CFTC Rule 3.10(c)(3):** Foreign advisers with non-US clients
4. **CFTC Rule 4.6(a):** Otherwise regulated entities
5. **CFTC Rule 4.6(a)(3):** CFTC-registered swap dealers
6. **CFTC Rule 4.14(a)(1):** Cash market transactions
7. **CFTC Rule 4.14(a)(2):** Non-profits
8. **CFTC Rule 4.14(a)(3):** APs
9. **CFTC Rule 4.14(a)(4):** CFTC-registered CPOs
10. **CFTC Rule 4.14(a)(5):** Exempt CPOs
11. **CFTC Rule 4.14(a)(6):** IBs
12. **CFTC Rule 4.14(a)(7):** RFEDs
13. **CFTC Rule 4.14(a)(8):** Investment advisers (registered and exempt)
14. **CFTC Rule 4.14(a)(9):** Publishers

When do commodity pool issues arise?

- Passive or managed funds or pools of capital
- Transactions that rely on special purpose entities, such as securitizations or repackaging transactions or those using financing vehicles
- Entities that may have fund-like characteristics, such as family offices, mortgage REITs or hedge funds

Why might you try to avail yourself of an exclusion or exemption from commodity pool/CPO status?

- A commodity pool is a de facto “financial entity” for Dodd-Frank Act Title VII purposes and not able to avail itself of the end-user exemption
- A CPO:
 - Must register with the CFTC
 - Must register its associated persons
 - Must ensure that its associated persons satisfy proficiency requirements
 - Must list its principals
 - Is subject to significant ongoing compliance obligations (which are reduced for registrations under Rules 4.7 and 4.12)



How are CPOs and CTAs regulated?

Overview of Compliance Obligations of CPO/CTAs

- A CPO is subject to comprehensive regulation by the CFTC and examinations by the NFA
- A CPO is subject to the CFTC's Part 4 rules, which govern items such as disclosures, reporting and recordkeeping.
- A CPO is subject to a supervision requirement
 - A requirement to maintain compliance policies and procedures designed to provide for appropriate custody of client assets; secure privacy of client information; comply with anti-money laundering requirements; prevent manipulative or disruptive trading practices; ensure business continuity; maintain accurate records, etc.
- A CPO is required to file certain annual and other reports, such as Forms CPO-PQR and CTA-PR

Disclosure Requirements

- Generally, absent registration under Rule 4.7, a disclosure document (or offering memorandum) must be delivered to a CPO investor no later than at the time a subscription is obtained
- There are specific requirements for the contents of disclosure documents
- CPOs must provide
 - Information about the principals
 - Information about the investment program
 - Risk factors
 - Fee disclosures
 - Past performance information
 - Information about potential conflicts of interest
 - Information about subscription amounts
- Investors must receive monthly account statements and an annual report
 - Annual reports must be certified by an independent certified public accountant

Advertising

- There are regulations that address communications by CPOs and their principals
- For example, CPOs are subject to rules that govern their communications with the public
 - Promotional materials, which may include a broad array of communications, are subject to content standards
 - Communications cannot be deceptive, fraudulent, or suggest that futures trading is generally appropriate for all persons
 - Communications must include discussions regarding risk of loss
 - There are substantial limitations on the use of past performance or of hypothetical performance
 - There are limitations on the use of testimonials
- NFA members are required to adopt and enforce written procedures for the supervision of compliance with rules related to communications
- The NFA Staff will review material submitted to it
- For funds, compliance with SEC rules may be sufficient for compliance with certain NFA communications rules

Ethics Training

- CPOs must have written ethics training programs
- Programs should cover a broad range of topics such as:
 - Applicable rules and regulations
 - The firm's obligations
 - Establishing supervisory systems
 - Internal controls
 - Conflicts of interest

Supervisory Procedures

- CPOs must establish appropriate supervisory procedures
- These will vary based on, among other things, firm size, the nature of activities, etc.
- Policies and procedures should address:
 - Hiring policies
 - Registration requirements
 - Customer information
 - Customer order procedures
 - Discretionary accounts
 - Sales practices
 - Promotional materials
 - Customer complaints
 - Customer funds
 - Ongoing training

Annual Requirements

- CPOs must conduct their own internal annual review of their internal procedures
- Supervisory personnel must review and attest to their review based on the annual review questionnaire and keep records
- CPOs also must submit an annual questionnaire to the NFA

Other Requirements

- CPOs are also subject to specific recordkeeping requirements
- CPOs are required to prepare certain periodic financial statements
- Relief from certain requirements may be available depending on whether interests are sold to qualified eligible persons, as well as where funds may in certain cases be subject to SEC rules
- Antifraud provisions apply

CPO Registration Under CFTC Rule 4.7

- There is a registration category that offers an exemption from many of the more onerous requirements associated with registration as a CPO.
- Registration under Rule 4.7, which is referred to as “registration lite,” provides an exemption from certain disclosure, reporting and recordkeeping requirements for registered CTA whose clients meet specified eligibility criteria.
- To qualify under Rule 4.7, the company must:
 - Register with the CFTC as a CTA.
 - Accept only investors or clients that satisfy the definition of “qualified eligible persons,” or “QEPs,” in CFTC Rule 4.7.
 - File a CFTC Rule 4.7 notice of exemption through NFA’s Exemption System.
 - Ensure that all offering memoranda contain the required CFTC disclaimers.



What exclusions and exemptions apply to CPOs and CTAs?

Exclusions from Definition of “Commodity Pool” – No-Action Relief

- The CFTC has issued no-action relief to the effect that certain vehicles that trade in swaps need not be considered “commodity pools”
- In no-action letters relating to securitization vehicles (each, an “SV”) and equity real estate investment trusts (each, an “equity REIT”), the CFTC has applied a fact-intensive analysis to determine whether an SV or equity REIT constitutes a commodity pool
- A primary inquiry is the extent to which such a vehicle’s entering into swaps actually drives (or could actually drive) the investment returns of investors in the vehicles, as opposed to being used for certain limited permitted uses (e.g., credit enhancement and altering rates or currency flows from underlying assets)
- On the next several slides, we highlight a few (but not all) of the no-action letters relating to CPO status

Securitizations – No-Action Relief

- CFTC No-Action Letter 12-14 (October 11, 2012) provides that a securitization vehicle will not constitute a commodity pool if it conforms to the following criteria:
 - The issuer of the asset-backed securities is operated consistent with the conditions set forth in Regulation AB, or Rule 3a-7, whether or not the issuer’s securities offerings are in fact regulated pursuant to either regulation;
 - The entity’s activities are limited to passively owning or holding a pool of receivables or other financial assets (either fixed or revolving) that by their terms convert to cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distributions of proceeds to security holders;
 - The entity’s use of derivatives is limited to the uses of derivatives permitted under the terms of Regulation AB, which include credit enhancement and the use of derivatives such as interest rate and currency swap agreements to alter the payment characteristics of the cash flows from the issuing entity;
 - The issuer makes payments to securities holders only from cash flow generated by its pool assets and other permitted rights and assets, and not from, or otherwise based upon, changes in the value of the entity’s assets; and
 - The issuer is not permitted to acquire additional assets or dispose of assets for the primary purpose of realizing gain or minimizing loss due to changes in market value of the vehicle’s assets.

Securitizations – More No-Action Relief

- CFTC No-Action Letter 12-45 (December 7, 2012) provides further detail with regard to securitization vehicles that may or may not constitute commodity pools:
 - “Certain securitization vehicles that do not satisfy the operating or trading limitations contained in Regulation AB or Rule 3a-7 may be properly excluded from the definition of commodity pool, provided that the criterion with respect to the ownership of financial assets continues to be satisfied and the use of swaps is no greater than that contemplated by Regulation AB and Rule 3a-7, and such swaps are not used in any way to create an investment exposure”
- To be clear, if investors in an SV have exposure to swaps which are used to create investment exposure (e.g., the payment to investors is affected by swaps in a way other than to enhance credit (within reason) or to swap interest rates or currencies, each as permitted by Regulation AB), then the securitization vehicle may be a commodity pool

Equity REITs – No-Action Relief

- CFTC No-Action Letter 12-13 (October 11, 2012) provides no-action relief for equity REITs, whose primary source of income is not derived from mortgage interest or fees (typically, they derive income from acquiring and developing their own properties)
- An equity REIT does not constitute a commodity pool if the REIT:
 - Primarily derives its income from the ownership and management of real estate and uses derivatives for the limited purpose of mitigating exposure to interest rate or currency fluctuation risk;
 - Is operated so as to comply with all of the requirements of a REIT election under the Internal Revenue Code, including the requirements that:
 - At least 75 percent of the equity REIT's annual gross income must be derived from qualifying real estate-related sources (the "75 Percent Test"); and
 - At least 95 percent of an equity REIT's annual gross income must consist of items that would satisfy the 75 Percent Test plus other passive income such as interest and dividends (the "95 Percent Test"); and
 - Has identified itself as an equity REIT in its last US income tax return and continues to qualify as such, or, if the REIT has not yet filed its first tax filing with the Internal Revenue Service, the REIT has stated its intention to do so and effectuates its stated intention

Mortgage REITS

- Mortgage REITs use interest rate and currency swaps and other derivatives to hedge the risks associated with the mortgage loans or MBS that they hold
- In letter 12-44 (December 7, 2012), the CFTC's DSIO provided limited relief for mortgage REITs that meet certain conditions
- Mortgage REITs may be deemed commodity pools but may indicate to the CFTC that they will satisfy the conditions limiting their use of derivatives and no enforcement action will be taken against them for not registering as CPOs
- This relief is different from the relief granted to equity REITs (which were specifically excluded from being considered CPOs), and as a result, mortgage REITs as non-registered CPOs will be deemed "financial entities" in the absence of further relief

Business Development Companies

- BDCs are closed-end funds and may use swaps for limited purposes
- CFTC makes clear that it considers BDCs to fit within the CPO definition
- December 4, 2012 – Letter 12-40 – DSIO staff clarified how Rule 4.5 exclusion applies to BDCs
 - Absent relief, BDCs cannot rely on Rule 4.5 exclusion
 - A BDC that enters into even one swap contract can trigger registration requirements
 - No-action letter applies the Rule 4.5 standards to BDCs
 - Limit swaps for bona fide hedging
 - Limit volume of activities
- No-action position has been codified in Part 4 of the CFTC’s rules; the adviser of a BDC can claim an exclusion from CPO registration with respect to the BDC, but the exclusion must be renewed annually

Pension Plan Group Trusts

- In letter 12-72 (December 21, 2012), the CFTC's DSIO granted relief from CPO and CTA registration with respect to pension plan group trusts
- The group trust at issue was formed and operated for the purpose of investing assets of participating trusts forming part of certain pension plans
- Each plan participating in the group trust was excluded from the definition of "pool," but there existed no similar provision for the group trust itself
- In accordance with prior practice, the CFTC granted CPO and CTA registration relief with respect to operating or advising the group trust

Fund of Funds Operators

- If a fund's manager acts as a CPO for one or more fund of funds, the manager may be able to rely on CFTC No-Action Letter 12-38 to avoid registration as a CPO.
- In order to rely on Letter 12-38, the amount of commodity interest positions to which the fund is directly exposed cannot exceed the levels specified in the "5% Test" or "Notional Test" (per CFTC Rule 4.13(a)(3)) and the manager must not know and could not have reasonably known that the fund's indirect exposure to commodity interests derived from contributions to the various funds exceed such levels, either calculated directly, or through the use of Prior Appendix A under Rule 4.13(a)(3) relating to such relief.
- Further, the fund for which the manager seeks relief must comply with Rule 4.13(a)(3)(i), (iii) and (iv) (i.e., that all interests in the pool are part of a private offering, the manager must have a reasonable belief that each pool participant is an accredited investor, qualified eligible person, knowledgeable employee or other enumerated type of sophisticated investor, and the pool is not marketed as a vehicle for trading in the commodity interest markets).
- Letter 12-38 relief is not self-executing, and the manager must file a claim to perfect the relief with the NFA with respect to the fund.

Family Offices

- Prior CFTC staff letters provided that family offices meeting specific criteria are not commodity pools.
- The CFTC adopted new Rules 13(a)(6) and 4.14(a)(11), codifying relief previously granted to family offices from CPO and CTA registration through CFTC Letters 12–37 and 14–143.
- The rules rely on the definitions of “family office” and “family client” from SEC Rule 202(a)(11)(G)–1.
- The exemption is self-executing for CPOs and CTAs.

Certain CPO Registration Exemptions by Rule

- 4.13(a)(1) – Closely held pool – not required to register as CPO if
 - Does not receive any form of compensation;
 - Operates only one pool at a time;
 - Not otherwise required to register with the CFTC; and
 - Does not advertise
- 4.13(a)(2) – Small pool – not required to register if
 - No pool has more than 15 participants (not including pool’s operator, CTA and certain other related persons); and
 - Total gross capital contributions in all pools do not exceed \$400,000

Certain CPO Registration Exemptions by Rule

- CFTC Rule 4.13(a)(3) provides a commodity pool-level exemption for an operator of a commodity pool where the pool trades a *de minimis* amount of commodity interests (e.g., swaps, options or futures).
- For a pool to claim the exemption, the following requirements must be met:
 - Interests in the pool 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;
 - The pool, at all times, meets one of the following two tests with respect to all of its commodity interest positions:
 - The aggregate initial margin, premiums, and required minimum security deposit for commodity interest transactions does not exceed 5% of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions (the "5% Test"); or
 - The aggregate net notional value of such positions does not exceed 100% of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions (the "Liquidation Test").

The 4.13(a)(3) Exemption *(cont'd)*

- The operator reasonably believes, at the time of investment, that each person who participates in the pool is:
 - An accredited investor,
 - A trust formed by an accredited investor for the benefit of a family member;
 - A knowledgeable employee; *or*
 - A qualified eligible person.
- Investments in the pool are not marketed as a vehicle for trading in or generating exposure from the commodity interest markets.
- Subject to limited exceptions, neither the operator nor any of its principals is subject to a statutory disqualification that would require disclosure under CEA §8a(2) if such person sought registration.
- The exemption is claimed by operators on a fund-by-fund basis via an electronic notice filing with the NFA.

Rule 4.5 Exemption

- An entity acting as a pool operator where the entity is one of the following:
 - An investment adviser registered under the Investment Advisers Act of 1940 that operates an investment company under the Investment Company Act of 1940 or operates a business development company that elected an exemption from registration as an investment company under the Investment Company Act of 1940;
 - An insurance company subject to state regulations;
 - A bank, trust or any other such financial depository institution subject to US regulation; or
 - A trustee of a named fiduciary or an employer maintaining a pension plan that is subject to ERISA.

Rule 4.5 Exemption *(cont'd)*

- If the person claiming the exclusion is an investment adviser, then the pool must be operated as follows:
- For bona fide hedging purposes:
 - Where derivatives trading will not exceed 5% of the liquidation value of the qualifying entity's portfolio or
 - Where the aggregate net notional values of the entity's commodity interest positions do not exceed 100% of the liquidation of the pool's portfolio.
- And where it will not be, and has not been, marketing participation to the public as a commodity pool or otherwise or as a vehicle for trading in commodity futures, commodity options or swap markets.
- Each person who has claimed an exemption from registration under this section must comply with certain participant disclosure requirements in CFTC Regulation 4.5(c)(2).



Recent Regulatory Changes

Recent CPO Rulemakings

- **Rule 4.5(a) Designation of the Adviser to a Registered Fund as the Excluded CPO**
 - Adviser to a RIC, rather than the RIC, is required to claim the Rule 4.5 CPO exclusion
- **Business Development Company CPO Exclusion**
 - New Rule 4.5 CPO exclusion for investment advisers to BDCs that engage in limited commodity interest activities
- **JOBS Act Harmonization**
 - Amendments to Rule 4.7(b) and Rule 4.13(a)(3) that permit CPOs relying on these rules to conduct general solicitation activities permitted by the JOBS Act
- **Bad Actor Provisions**
 - Adding statutory disqualification persons in order to claim an exemption under Rule 4.13

Recent CPO Rulemakings

- **Form CPO-PQR and CTA-PR Reporting Persons Relief**
 - Rule 4.27 amendments to eliminate the requirement to file Forms CPO-PQR and CTA-PR for registered CPOs and CTAs providing services to exempt pools or accounts
- **Acceptance of Non-US Persons and other Rule 4.7 “QEPs” in Rule 4.13(a)(3) Exempt Pools**
 - Rule 4.13(a)(3) amendments to clarify that all QEPs (as defined in Rule 4.7), including non-US persons, are permissible participants in Rule 4.13(a)(3) “de minimis” pools
- **Family Office Exemption**
 - Exemptions from CPO and CTA registration for “family offices” (as defined in SEC rules), adopted as new Rules 4.13(a)(6) (for CPOs) and 4.14(a)(11) (for CTAs)

Recent CPO Rulemakings

- **Rule 3.10(c)(5) Amendments**

- Pool-by-Pool Exemptions

- A non-US CPO may rely on the exemptive relief even if it serves as a CPO to other pools in which US persons are invested

- Permitted Seed Investments by US Affiliates

- Initial capital contributions to a pool made by a US affiliate of a non-US CPO may be disregarded in determining whether participation in that pool is limited to only foreign located persons

- Safe Harbor

- A non-US CPO that satisfies several conditions, which focus on non-US persons and activities, may rely on a safe harbor



Enforcement Considerations

Enforcement Considerations

- **CFTC Enforcement**

- The CFTC administers the CEA and has wide-ranging civil enforcement powers.
- Civil and administrative authority, not criminal
- Brings actions in federal court or administratively
- Main office is in D.C., with branches in New York, Chicago, and Kansas City

- **DOJ Enforcement**

- The DOJ, via main Justice or a US Attorney's office, has the power to prosecute criminal conduct
- Most active offices: Main Justice (DC), S.D.N.Y., and N.D. IL
- DOJ Fraud Section has created a commodities subsection and announced an increased commitment to such prosecutions

Enforcement Considerations

- **Failure to Register**
 - Misplaced reliance on exemptions
 - Riskiness
 - Type strategy / strategy shift
- **Misappropriation of Funds**
 - Personal use
 - Expenses
- **Misuse of Material, Non-Public Information**
 - Duties associated with client confidential information
- **Misrepresentations in Offering Materials and Presentations**
 - Performance/Track Record
 - Qualifications
- **Failure to Supervise**
 - Insufficient training, procedures, etc.

Enforcement Considerations

- **Self reporting, cooperation and remediation**
- 2017 and 2020 CFTC Guidance
 - Each consent order will fall within one of four categories depending on the extent of cooperation.
- Example: “In accepting the Offer, the Commission recognizes [Respondent’s] self-reporting, cooperation, and remediation in the form of a ***substantially reduced civil monetary penalty.***”
- Should you self-report?
- What is the value of cooperation?

Enforcement Considerations

- **Key Considerations / Trends**

- Individual Accountability
- Use of Strict Liability (via CEA Section 2(a)(1))
- Spot market enforcement – *e.g.*, trading in cryptocurrencies
- Cross-regulator Referrals
- Cross-border Referrals
- Adequacy of Compliance Procedures, Training and Surveillance
- Criminal Referrals to DOJ

At the Crossroads: CFTC and DOJ Enforcement

AT THE CROSSROADS: CFTC AND DOJ ENFORCEMENT IS A WEEKLY VIDEO SERIES HOSTED BY MAYER BROWN PARTNERS

Matt Kluchenek and Glen Kopp. Each episode, they discuss a topic at the intersection of enforcement by the US Commodity Futures Trading Commission (CFTC) and the US Department of Justice (DOJ).

THE GOAL:

To help legal and compliance departments protect their organizations in an increasingly rigorous regulatory environment.

EPISODE 1:

INSIDER TRADING IN THE
COMMODITIES/DERIVATIVES
MARKETS

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WATCH THE VIDEO



Matt and Glen explore recent enforcement activities by the CFTC and DOJ and how market participants can protect themselves.

EPISODE 2:

JOINT VS. PARALLEL
INVESTIGATIONS

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There's been an increase in cooperative enforcement activities by the CFTC and the DOJ. Matt and Glen discuss a recent decision and explore the differences between "joint" vs. "parallel" investigations and the implications for defendants and their employers, as well as for the agencies.

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Named **Global Law Firm of the Year** by *GlobalCapital* at the 2019 Global Derivatives Awards.



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 Named **US Law Firm of the Year – Transactional** in 2020 and **Americas Law Firm of the Year** by *GlobalCapital* at the 2019 and 2018 Americas Derivatives Awards



Ranked by *Chambers USA* for Nationwide: Capital Markets: Derivatives



Ranked by *IFLR1000* for Derivatives and Structured Finance & Securitisation in the United States



Ranked Tier 1 for Structured Finance: Derivatives & Structured Products by *Legal 500 US*



Ranked by *US News/ Best Lawyers' Best Law Firms* for Derivatives and Futures Law



Ranked by *Chambers UK* for London (Firms): Capital Markets: Derivatives



Ranked by *IFLR1000* for Derivatives in the UK and Structured Finance* & Securitisation in Germany and France



Ranked by *Legal 500 Deutschland* for Capital Markets: Structured Finance* and Securitisation and ranked by *Legal 500 UK* for Derivatives (including commodities) and for Structured products and securitization.



Ranked by *Chambers Europe* for Capital Markets: Structured Finance* Europe-wide and in Germany



Ranked by *Chambers Asia-Pacific* for Banking & Finance: Capital Markets* in China and Vietnam



Ranked by *IFLR1000* for Structured Finance* & Securitisation in Hong Kong



Ranked by *Legal 500 Asia-Pacific* for Hong Kong: Structured Finance* and Securitisation and for Vietnam: Capital Markets

*Include derivatives & structured products rankings.

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