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Complying with the CFTC's New Statutory Disqualification Bar for Exempt CPOs — Answers to Frequently Asked Questions

I. Introduction and Executive Summary

At an open meeting held on June 4, 2020, the Commodity Futures Trading Commission (the "**CFTC**" or the "**Commission**") unanimously adopted amendments to Rule 4.13, the Commission's rule providing a number of commodity pool operator ("**CPO**") registration exemptions for persons engaged in certain limited CPO activities, that impose an important new condition.[1] The amendments require a person claiming a CPO exemption under Rules 4.13(a)(1), (2), (3), or (5) (the "**Covered Exemptions**") to represent that "neither the person nor any of its principals has in its background a statutory disqualification that would require disclosure under section 8a(2) of the [Commodity Exchange] Act if such person sought registration," with a limited exception for matters previously disclosed in an application for registration that was granted (the "**Section 8a(2) Representation**"). This requirement is imposed under a new paragraph (b)(1)(iii) of Rule 4.13, which effectively acts to bar persons that have a Section 8a(2) statutory disqualification in their background, or whose principals do, from relying on a Covered Exemption, unless the limited exception is available or the person obtains an individual exemption (the "**Section 8a(2) Bar**"). The amendments finalize a proposal published in October of 2018 (the "**Proposal**"), with significant changes made in response to concerns raised by commenters on the Proposal.[2]

The amendments (the "**Final Rule**") became effective on September 8, 2020. However, the Commission extended the compliance date for CPOs with existing claims filed under one of the Covered Exemptions; such CPOs may continue to rely on these existing claims until March 1, 2021, the date for annual reaffirmation of reliance on the Exemptions.[3]

The Covered Exemptions include Rule 4.13(a)(3), the exemption for CPOs offering private funds with only de minimis commodity trading activity, on which many Securities and Exchange Commission ("**SEC**") registered investment advisers ("**RIAs**") rely. The Final Rule presents a substantial new requirement for these RIAs and other asset managers that rely, or seek to rely, on one of the Covered Exemptions, with related compliance and due diligence obligations. These include, depending on the circumstances: (1) establishing a due diligence process to identify statutory disqualifications in the background of the CPO and its principals and (2) gaining an understanding of the two-tiered statutory

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[1] Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors: Prohibiting Exemptions Under Regulation 4.13 on Behalf of Persons Subject to Certain Statutory Disqualifications, 85 Fed. Reg. 40,877 (July 8, 2020), https://www.federalregister.gov/d/2020-12607 (the "**Adopting Release**").

[2] Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors, 83 Fed. Reg. 52,902 (Oct. 18, 2018), https://www.federalregister.gov/d/2018-22324. (the "**Proposing Release**").

[3] Adopting Release at 40,877.

disqualification framework of the Commodity Exchange Act (the "**CEA**" or the "**Act**") that is sufficient to determine whether an identified statutory disqualification falls within Section 8a(2) and thus is within the scope of the Section 8(a)(2) Representation. For a number of reasons, the impact of the Final Rule will differ depending on whether the person relying on one of the Covered Exemptions is a registered CPO claiming the exemption for one or more pools or a fully exempt (unregistered) CPO.

Given the novel, and in some respects complex, features of the new requirements, this Client Alert will describe the Final Rule and address interpretive and other practical issues that may arise in a "Frequently Asked Questions" ("**FAQ**") format.

II. Final Rule FAQs

A. Text and Operation of the Section 8a(2) Representation

1. What is the new representation required by the Final Rule?

A person relying on one of the Covered Exemptions must make the following representation:

> [N]either the person nor any of its principals has in its background a statutory disqualification that would require disclosure under section 8a(2) of the Act if such person sought registration, unless such disqualification arises from a matter which was disclosed in connection with a previous application for registration, where such registration was granted[.][4]

A statutory disqualification requiring disclosure under Section 8a(2) of the CEA is sometimes referred to as a Covered Statutory Disqualification (a "**CSD**").[5] A discussion of Section 8a(2) and CSDs, as well as the exception for matters disclosed in a previous registration application, is provided in Section B of these FAQs. A discussion of the term "principal" is provided in Section A.3 of these FAQs, below.

2. Which CPO exemptions are Covered Exemptions that require the Section 8a(2) Representation?

The Section 8a(2) Representation is required for any person relying on an exemption provided by Rules 4.13(a)(1), (2), (3), or (5), all of which provide registration relief to CPOs engaged in different types of limited commodity interest activities.[6] For RIAs and their affiliates, the Covered Exemption most commonly relied on is Rule 4.13(a)(3), which provides an exemption for CPOs of private funds that engage in a de minimis amount of commodity interest trading.[7]

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[4] Rule 4.13(b)(1)(iii).

[5] Adopting Release at 40, 879.

[6] Rule 4.13(a)(1) provides an exemption for a CPO that operates only one commodity pool at any time, with additional restrictions relating to receipt of compensation, additional regulated activities and advertising for the pool; Rule 4.13(a)(2) provides an exemption for a CPO operating only pools with 15 or fewer participants and whose aggregate gross capital contributions received from participants in all such pools do not exceed $400,000, excluding contributions from the pools' CPO, commodity trading advisor ("**CTA**") and certain family members thereof; and Rule 4.13(a)(5) provides an exemption for directors of exchange-traded funds operated by a registered CPO. Rule 4.13(a)(3) is described in note 7, below.

[7] Rule 4.13(a)(3) provides an exemption for operation of any pool where (a) the interests in the pool are exempt from registration under the Securities Act of 1933; (b) interests are marketed and advertised to the public, if at all, in compliance with SEC exemptive rules 506(c) and 144A; and (c) at all times, the pool meets one of two de minimis commodity interest trading restrictions (either (i) aggregate initial margin does not exceed five percent of the pool's liquidation value or (ii) the aggregate net notional value of such positions does not exceed 100 percent of the pool's liquidation value, in each case with specific requirements as to how these trading requirement are calculated).

The Representation is not required for CPOs claiming the exemption for family offices provided by Rule 4.13(a)(6), which was adopted in 2019.[8]

3. Who is Considered a "Principal"?

CFTC Rule 3.1(a) defines the term "**principal**" to cover a range of individuals and entities with management authority or responsibilities or significant power over the CPO by virtue of ownership or capital contributions. The definition includes individuals in a number of specific positions with the CPO (either by title or function) for different types of corporate entities, including managing members, directors, company presidents, corporate executives, chief compliance officers, as well as individuals and entities with a ten percent or more ownership interest (defined in various ways) in the CPO. There are also subjective elements of the definition. For example, in addition to including persons with certain titles, the term principal includes "any person in charge of a principal business unit, division or function subject to regulation by the Commission," as well as "any person occupying a similar status or performing similar functions, having the power, directly or indirectly, through agreement or otherwise, to exercise a controlling influence over the entity's activities that are subject to regulation by the Commission."[9]

4. Where is the Section 8a(2) Representation made?

Rule 4.13(b) requires that any person who wishes to claim the relief from registration provided by a Covered Exemption must file a notice of exemption (often called a claim) with the National Futures Association ("**NFA**") through its electronic exemption filing system and must reaffirm the claim of exemption annually within sixty days of the end of the prior calendar year.

New paragraph (b)(1)(iii) of the Final Rule requires that the Section 8a(2) Representation must be included in the claim filed for reliance on a Covered Exemption and in each annual affirmation thereof. The form of notice on the NFA's filing system includes the Representation.

5. When is the Section 8a(2) Representation required?

For a CPO relying on a Covered Exemption for a new pool, the Section 8a(2) Representation must be made in the first notice filed to claim the exemption, which must be filed no later than the time the CPO delivers a subscription agreement for the pool to prospective participants.[10]

For pools where the CPO has an existing notice filed prior to September 8, 2020 (the effective date of the Final Rule), the CPO must make the Representation in connection with the CPO's first annual notice reaffirming reliance on the Covered Exemption, which is due no later than March 1, 2021.[11]

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[8] *See* Registration and Compliance Requirements for Commodity Pool Operators (CPOs) and Commodity Trading Advisors: Family Offices and Exempt CPOs, 84 Fed. Reg. 67,355 (Dec. 10, 2019), https://www.federalregister.gov/d/2019-26162.

[9] *See* 17 C.F.R. § 4.10(e)(1) (making the definition of "principal" in 17 C.F.R. § 3.1(a) applicable to 17 C.F.R. pt. 4). The full definition of principal, which is very detailed and includes a number of important distinctions and nuances, can be found here: https://www.law.cornell.edu/cfr/text/17/3.1.

[10] *See* Rule 4.13(b)(2).

[11] Adopting Release at 40,877.

6. What happens if a CPO cannot make the Section 8a(2) Representation?

A CPO that cannot truthfully make the Section 8a(2) Representation would not be eligible for the Covered Exemptions.[12] The Commission described the Representation requirement as a "threshold requirement" for any person seeking to claim an exemption from registration under one of the Covered Exemptions.[13]

Accordingly, a CPO that does not make the Section 8a(2) Representation will not be permitted to file the claim necessary to rely on a Covered Exemption, and may not serve as an exempt CPO for the pool, absent obtaining an individual exemption as described below.[14] With respect to existing claims filed before September 8, 2020, if the CPO cannot make the Section 8a(2) Representation in the annual notice reaffirming the claim (on or before March 1, 2021), the CPO must withdraw the claim and either register as a CPO or cease operating the pool in question. Following the applicable compliance date, a person with an existing claim that can no longer make the Section 8a(2) Representation would be required to withdraw the claim within fifteen days after the person learns that the Representation is inaccurate.[15]

Note that the CPO may truthfully make the Section 8a(2) Representation if the relevant matter qualifies for the limited exception for disclosure in connection with a registration application that is built into the Representation. The scope of this exception is discussed below.

7. Is there a way to obtain a waiver or exemption from the Section 8a(2) Bar?

A person that cannot make the Section 8a(2) Representation may seek an individual or firm exemption from the requirement from the Director of the Commission's Market Participants Division ("**MPD**"), who has the delegated authority to grant such an exemption. Such a request would require the person to demonstrate, through presentation of the relevant facts and circumstances, that such relief would be consistent with the public interest and the purposes of the Final Rule, which is to provide some customer protection to exempt pool participants.[16]

The Adopting Release states that the Commission recognizes that "there may be facts and circumstances, pursuant to which permitting such disqualified CPOs and principals to operate exempt commodity pools may not be inconsistent with the Commission's customer protection concerns."[17] However, the Adopting Release cautions that such exemptions would be granted infrequently and only on a strong factual and legal showing.[18]

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[12] *Id.* at 40,884.

[13] *Id.*

[14] The form of the claim on the NFA's system includes the representation. Accordingly, based on this mechanism, a person cannot physically file the claim without making the representation.

[15] *See* Rule 4.13(b)(5).

[16] Adopting Release at 40,885-86.

[17] *Id.* at 40,885.

[18] *Id.* at 40,886.

B. Scope of Covered Statutory Disqualifications; Section 8a(2) of the CEA; the Limited Registration Disclosure Exception

The Section 8a(2) Representation requires the claimant to confirm the absence of CSDs in the background of both the CPO claiming the exemption and its principals. As noted, above, the term CSD refers to a "statutory disqualification that would require disclosure under section 8a(2) of the Act" if the CPO sought registration. This section addresses the scope of Section 8a(2) and provides background information that may be helpful in understanding the types of events that will be considered CSDs. We also include information about reliance on the limited exception provided in the representation.

1. What is covered by Section 8a(2) of the CEA?

Section 8a(2) of the CEA lists a number of offenses and disciplinary actions, on the basis of which the Commission may refuse registration with notice but without opportunity for a hearing.[19] The offenses that fall within Section 8a(2) have been variously described as the "most serious," "most egregious and recent," and "especially grave" offenses, that are so clearly related to a person's fitness for registration with the Commission that they trigger refusal of registration without opportunity for a hearing.[20] Accordingly the Commission has described persons with Section 8a(2) statutory disqualifications in their background as "unregisterable."[21]

To put this in context, Section 8a(2) is part of a two-tiered framework under which the Commission determines the "fitness" of persons who seek to register with the Commission in order to engage in activities that, absent such registration, are prohibited under the CEA and the Commission's rules. The two-tiered framework was adopted by Congress in 1982 in order to streamline the registration process by dividing background offenses into two levels, which would determine whether a hearing is necessary to deny registration.[22] The two tiers are set out in Sections 8a(2) and 8a(3) of the CEA. Section 8a(2), which is the first tier, identifies offenses with a level of gravity meriting denial of registration without a hearing. By contrast, Section 8a(3), the second tier, identifies offenses on the basis of which the Commission may deny registration only after opportunity for a hearing. Section 8a(3) enumerates offenses that are less grave, may require fact finding, or for which it may be appropriate for the Commission to consider mitigating or extenuating circumstances or evidence of rehabilitation.[23]

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[19] More specifically, Section 8a(2) authorizes the Commission "upon notice, but without a hearing and pursuant to such rules, regulations, or orders as the Commission may adopt, to refuse to register, to register conditionally, or to suspend or place restrictions upon the registration of, any person and with such a hearing as may be appropriate to revoke the registration of any person," based on the matters enumerated in Section 8a(2)(A) – (H).

[20] *See* Adopting Release at 40,883-84; H.R. Rep. No. 97-565, at 49, 95–98 (1982).

[21] *See* Adopting Release at 40,880. As explained in the Adopting Release, persons seeking registration with the Commission and their principals are required to disclose matters enumerated in Section 8a(2) in their registration application, and are generally refused registration if such matters are disclosed or found to exist in their backgrounds.

[22] *See* H.R. Rep. No. 97-565, at 49–50 (1982).

[23] *Id.* at 49, 95–100.

The Adopting Release addresses the important distinction between these two categories at some length, because as proposed, the bar would have included Section 8a(3) statutory disqualifications as well as those under Section 8a(2).[24] In response to concerns raised by commenters, the Final Rule narrowed the scope of the bar to cover Section 8a(2) only.[25] The Commission was persuaded by commenters that, given the limited nature of the commodity interest activities permitted by the Covered Exemptions and the purpose of the bar, it was appropriate to restrict the bar to only "the most serious statutory disqualifications" that do not require a hearing in order to refuse registration, which are those covered in Section 8a(2).[26]

2. What are some examples of matters listed in Section 8a(2)?

Statutory disqualifications enumerated in Section 8a(2) include, among others:

- A court injunction against the applicant's acting as a CPO, CTA, securities broker or dealer, investment company or investment adviser (or affiliated or associated person thereof);[27]
- A conviction within the prior ten years of a felony involving (i) certain financial activities or (ii) embezzlement, theft, extortion, fraud, fraudulent conversion, misappropriation of funds, securities or property, forgery, counterfeiting, false pretenses, bribery or gambling;[28] and
- A finding, within the prior ten years, in a proceeding brought by another regulatory agency (such as the SEC) of a violation of the federal securities laws or related laws involving embezzlement, theft, extortion, fraud, fraudulent conversion, misappropriation of funds, securities or property, forgery, counterfeiting, false pretenses, bribery or gambling (the "**Bad Actor Offenses**").[29]

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[24] The representation as proposed, which was based on similar representations required for registered CPOs claiming exemptions from some of the Commission's CPO rules under Rule 4.7 or Staff Advisory 18-96, would have required a representation that "neither the person nor any of its principals is subject to any statutory disqualification under section 8a(2) or 8a(3) of the Act, unless such disqualification arises from a matter which was previously disclosed in connection with a previous application, if such registration was granted, or which was disclosed more than thirty days prior to the claim of this exemption." Proposing Release at 52,914. Note that as proposed, the representation would have included a second exception, not adopted in the Final Rule, for matters disclosed more than 30 days prior to the claim. Proposing Release at 52,927. In response to the NFA's concern that, for exempt CPOs, there would be no mechanism requiring ongoing disclosure to the Commission or NFA of new or recent statutory disqualifications to which the exempt CPO or its principals may be subject, the Commission determined not to include this exception. Adopting Release at 40,884.

[25] Adopting Release at 40,883.

[26] As the Adopting Release further explains, narrowing the representation to Section 8a(2) statutory disqualifications was consistent with the purpose of the Final Rule, which is to establish a basic conduct standard applicable to both exempt and registered CPOs, so that persons that would not be permitted to register as CPOs – and thus are considered "unregisterable" – would also be prohibited from managing customer money as exempt CPOs. *Id.* at 40,882–83.

[27] Section 8a(2)(C). The full text of Section 8a, including Sections 8a(2) and 8a(3), can be found here: https://www.law.cornell.edu/uscode/text/7/12a.

[28] Section 8a(2)(D).

[29] Section 8a(2)(E). Both Section 8a(2)(E) and 8a(3)(B), described below, which address findings in regulatory proceedings, specify the inclusion of findings by agreements of settlement to which the SEC or other regulator is a party. Note, however, that prior CFTC case law has limited the CFTC's authority to refuse registration based only on the finding in a settlement to which the respondent agreed solely for purposes of that proceeding and without admitting the allegation. *See Frederic S. Mates,* CFTC No. 79-10, Comm. Fut. L. Rep. (CCH) ¶ 21,852, 1980 WL 15665 (Dec. 2, 1980); *cited as support, Tafoho v. Forex Capital Markets,* CFTC No. 17-R008, Comm. Fut. L. Rep. (CCH) ¶ 34,789 (Sept. 3, 2020).

By contrast, matters enumerated in Section 8a(3), which would require a hearing in order to determine the applicant's fitness, include, among others:

- Guilty pleas or convictions of certain misdemeanors, or of felonies not covered by Section 8a(2) or that occurred prior to the last ten years;[30]
- A finding, without a time limit, in a proceeding brought by another regulatory agency (such as the SEC) of a violation of the federal securities laws or related laws that does not involve one or more of the Bad Actor Offenses;[31] and
- Other good cause.[32]

3. When can a CPO rely on the exception for registration disclosures?

The Section 8a(2) Representation provides an exception for a disqualification that "arises from a matter which was disclosed in connection with a previous application for registration, where such registration was granted." This exception may be useful for registered CPOs that claim a Covered Exemption for certain pools while maintaining their CPO registration status.[33] While the language of the exception by itself is not entirely clear, a statement in the Adopting Release (cited below) indicates, and discussions with MPD staff have confirmed, that a registered CPO can rely on the exception with respect to matters that have been disclosed in the registration statement updating process subsequent to the initial grant of registration, as long as neither the CFTC nor the NFA has taken adverse action based on the disclosure.

Commission and NFA rules require any person applying for registration with the Commission and their natural person principals to complete Forms 7–R and 8-R, respectively, both of which Forms require disclosure of matters that would give rise to a statutory disqualification, whether covered by Section 8a(2) or 8a(3).[34] According to the Adopting Release, "[i]f a statutory disqualification enumerated in CEA section 8a(2) is disclosed or otherwise revealed through that process, such applicant is generally refused registration on that basis, and such statutorily disqualified principals will generally not be listed with the Commission."[35]

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[30] Section 8a(3)(D) and (E).

[31] Section 8a(3)(B).

[32] Section 8a(3)(M).

[33] Rule 4.13(a)(3) permits registered CPOs to claim the exemption for one or more pools, while serving in the CPO's registered capacity for other pools. The Adopting Release notes that several hundred CPOs currently maintain registration simultaneously with one or more CPO exemptions, due to the nature of the various commodity pools they operate. Adopting Release at 40,884-85.

[34] Each of the Forms inquires specifically about matters enumerated in both Section 8a(2) and Section 8a(3). As explained in the release accompanying adoption of certain amendments to Form 7-R: "The sections in Form 7–R titled ''Disciplinary Information—Criminal Disclosures,'' ''Disciplinary Information—Regulatory Disclosures,'' and ''Disciplinary Information— Financial Disclosures'' contain a series of questions that inquire about the disciplinary history of the applicant. These questions are designed to identify and gather information that may reflect on the fitness of the applicant and whether the applicant may be subject to a statutory disqualification from registration" (omitting the footnote, which cites to Sections 8a(2) and 8a(3)). Revised Registration Form 7-R, 84 Fed. Reg. 8,671, 8,672 (Mar. 11, 2019). *See* Firm Application (Form 7-R) at 22, https://www.nfa.futures.org/registration-membership/templates-and-forms/Form7-R-entire.pdf ("**Form 7-R**"); *see also* Individual Application (Form 8-R), https://www.nfa.futures.org/registration-membership/templates-and-forms/8rFormentire.pdf ("**Form 8-R**"). The Adopting Release states that Form 7-R also requires the applicant to certify that it would not be statutorily disqualified from registration under section 8a(2) or section 8a(3) of the Act. Adopting Release at 40,878 n.9. However, it appears that this certification is required only from persons seeking exemption from registration as an introducing broker, CPO, or CTA pursuant to Rule 30.5. *See* Form 7-R at 22. If the principal is a non-U.S. natural person, under certain circumstances Form 8-R requires the sponsoring CPO to affirm that a criminal background check was performed that did not reveal any matters constituting a disqualification under Section 8a(2) or 8a(3) other than those disclosed to the NFA. The CPO must also acknowledge that it is the duty of the CPO not to employ an individual with a Section 8a(2) statutory disqualification as an associated person, and to notify the NFA if that occurs.

[35] Adopting Release at 40,878.

Following the grant of registration, Forms 7-R and 8-R also require registered CPOs to amend the Forms on a current basis to disclose the occurrence of any new matters giving rise to a statutory disqualification.[36] As the Adopting Release notes:

> In the event such an otherwise registered CPO or a principal thereof did have a CSD, it would likely fall under the exception discussed above for CSDs identified by the person and/or principal in a prior approved application for registration, in light of their existing status as a registrant and the obligation to disclose such offenses as they occur.[37]

Moreover, staff of MDP have provided clarification on this point, to the effect that, for registered CPOS, if after a CPO's registration has been approved, a subsequent offense is disclosed on Form 7-R or 8-R in connection with ongoing obligations to update such disclosures and no action has been taken by the CFTC or NFA post-disclosure to revoke the CPO's registration (*i.e.,* the CPO remains registered), the CPO can also rely, or continue to rely, on the Covered Exemptions for exempt pools and make the Section 8a(2) Representation, in reliance on the exception.[38]

C. Compliance, Due Diligence, and Monitoring

1. What kind of due diligence should a CPO relying on a Covered Exemption conduct to ensure compliance with the Section 8a(2) Representation?

Persons relying on one of the Covered Exemptions should ensure that they have a process in place both to identify principals and to identify relevant statutory disqualifications to which either the CPO or its principals is subject. This process should be conducted in a timely manner so that, should an issue emerge, there will be sufficient time to resolve the issue and, if necessary, make appropriate changes to regulatory filings and the CPO's operations.

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[36] In 2014, the NFA adopted rule changes that impose a $1,000 fee on a firm or individual that fails to disclose a disciplinary matter on a registration application or fails to promptly update an existing registration record to disclose a new disciplinary matter. In addition, if, upon review, the NFA determines the failure to disclose was willful, the NFA may take an adverse registration action. Notice to Members I-14-11, May 19, 2014 (Late Disclosure Filing Fee), https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=4420.

[37] Adopting Release at 40,885; *see also id.* at 40,884 ("The Commission believes that this result maintains the strength of the amendment, while permitting flexibility for circumstances where the Commission has affirmatively determined that a CSD in a person's background should not impede that person's ability to register").

[38] This interpretation of the exception is also consistent with, indeed impelled by, the purpose of the Rule, which is to prohibit "unregisterable" CPOs from managing customer money on an exempt basis. A registered CPO that has disclosed all background matters and remains registered could not be considered "unregisterable."

The due diligence process is likely to be substantially easier for registered CPOs that also rely on a Covered Exemption than for fully exempt CPOs. As described above, registered CPOs will already both have identified principals and gone through the identification and disclosure of statutory disqualifications in connection with their initial registration, and are obligated to monitor for and disclose all statutory disqualifications on an ongoing basis. Furthermore, registered CPOs will be able to rely in appropriate cases on the limited exception described above.

a. Identification of Principals

Registered CPOs will be familiar with the CFTC's definition of principal, as they are required to identify and report principals on an ongoing basis. Exempt CPOs, however, will be required to review their organizational structure and personnel functions to ensure that all entities and individuals that fall within the definition of principal are identified.

As indicated above (see FAQ Section II.A.3., Who is Considered a Principal?), the definition of principal, in addition to specifying objective criteria, has a number of subjective elements, which can make the identification process more complex and resource-intensive. The Adopting Release recognizes that some classes of principals "may involve a factual analysis to determine status."[39] However, the Commission expressed the view that the detailed definitions in its rules, which "detail the roles, titles, ownership, and responsibilities that can give rise to a person being a 'principal' of a registrant," will reduce these challenges.[40] Whether the Commission is correct in its expectation that given the detail in its rules, "most persons will be able to determine their principals relatively easily," certainly a comprehensive review of these rules will be the starting point in conducting the identification of principals necessary as a predicate to compliance with the Section 8a(2) Representation.[41]

b. Statutory Disqualification Questionnaire

Once principals are identified, there are a number of ways that the existence or absence of Section 8a(2) statutory disqualifications in the background of the CPO or its principals can be confirmed. Typically, this is accomplished by means of a questionnaire to be completed by the CPO (through its knowledgeable officers) and by each principal, in consultation with the CPO's legal or compliance personnel. One approach could be to create a questionnaire based on the disclosure items specified in Forms 7-R and 8-R, together with the relevant portions of the Forms' instructions and definitions, and revised to include questions about CFTC and NFA regulatory actions.[42] These Forms are designed to elicit information about statutory disqualifications in plain English, without relying on references to specific statutory provisions, and may be easier for individuals not familiar with the CEA's statutory disqualification framework to understand. Relevant personnel of the CPO would then conduct

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39 Adopting Release at 40,885.

40 *Id.*

41 *Id.*

42 Disclosure of statutory disqualifications that arise from CFTC and NFA proceedings is not required on the registration forms, because the NFA has independent knowledge of those proceedings. However, due diligence by an exempt CPO should include these matters as well.

a review of this information, in consultation with counsel as appropriate, to determine whether a particular matter gives rise to statutory disqualification under Section 8a(2).[43]

Registered CPOs should already have such a process in place for the purpose of ensuring compliance with the Form 7-R and 8-R updating requirements. The new step for registered CPOs would be to connect this process in place for registration with any separate work streams dedicated to the exemption process. Registered CPOs may also have exempt affiliates that are required to make the Representation, and may wish to assist in coordinating the due diligence on an organization-wide basis.

2. Can RIAs rely on due diligence they conduct for required disclosures in Form ADV, fund registration statements, or other disclosures required by the federal securities laws?

The Final Rule does not provide any special treatment or carve-out for RIAs. Several commenters requested that the Commission exclude RIAs from the proposed amendment, on the basis that such RIAs are already subject to robust conduct requirements in the Investment Advisers Act of 1940 (the "**Advisers Act**"), which, commenters urged, the new representation would only serve to duplicate.[44] While agreeing that RIAs are subject to conduct requirements under the Advisers Act, the Commission found that the statutory disqualification scheme of the Advisers Act is materially different from the corresponding provisions of the CEA, and declined to exclude RIAs from the Section 8a(2) Representation.[45] In particular, the Commission noted that the Advisers Act does not have a provision, similar to Section 8a(2), that specifies statutory disqualifications that bar investment advisers from registration without a procedural hearing or order.[46]

The Adopting Release notes that "most RIAs would not present any cause for reservation in permitting them to operate in the commodity interest markets," and based on their registration status with the SEC, the majority of RIAs should be able to easily comply with the Section 8a(2) Representation.[47] Nonetheless the Commission concluded that its public interest concerns would be best served by preserving the Commission's independent authority to determine which persons should be permitted to operate commodity pools in its markets, whether registered or exempt, under the terms of the CEA and the Commission's rules, which reflect the unique regulatory concerns associated with intermediaries in the commodity interest markets.[48]

3. Can A CPO rely on the due diligence questionnaire used to identify "Bad Actor Disqualifications" for purposes of SEC Regulation D?

The SEC's Regulation D also has a set of "bad actor disqualifications," for which sponsors of private funds routinely conduct due diligence through the use of questionnaires.[49] A CPO could

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[43] Forms 7-R and 8-R do not require the applicant to indicate on the Form whether these disclosure items fall specifically within Section 8a(2) or 8a(3).

[44] Adopting Release at 40,885.

[45] *Id.* at 40,885.

[46] The Adopting Release points out that Section 203(e) of the Advisers Act "covers censures, denials, or suspensions of registration for investment advisers and provides the SEC the authority to censure, limit, suspend, or revoke the registration of any investment adviser, if, after notice and opportunity for a hearing, certain statutory disqualifications of the adviser or persons associated with it are proven and such adverse action is in the public interest." Adopting Release at 40,885.

[47] Adopting Release at 40,885 & n.85.

[48] *Id.*

[49] *See* Securities Act of 1933, Rule 506(d).

choose to add questions relating to CEA statutory disqualifications to such a questionnaire. However, both the persons subject to such disqualifications and the matters requiring disclosure are sufficiently different that the Regulation D questionnaire on its own would not suffice. If one questionnaire is used for both purposes, for purposes of clarity and in order to ensure accurate responses, it would be advisable to state the different items separately, rather than try and merge them, which could lead to confusion and information gaps. In addition, the CPO should ensure that the questionnaire is completed by all persons considered principals under the CFTC's definition, and the questionnaire should indicate which persons must answer each question.

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