

Investment Management

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CFTC Finalizes Long-Awaited Update to Rule 4.7

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What You Need To Know:

The final rule updates various provisions of the regulation, which have remained unchanged since its original adoption in 1992. Specifically, the final rule:

- Amends the definition of “Portfolio Requirement” by increasing the thresholds for securities portfolio, initial margin, and premiums. These revised thresholds must be met for prospective pool participants to qualify as “Qualified Eligible Persons” under the Rule 4.7 exemption.
- Codifies the exemptive relief typically granted to CPOs operating as funds of funds, allowing them to distribute account statements to pool participants monthly, within 45 days of month-end.
- Requires CPOs to comply with the increased Portfolio Requirement thresholds six months after the final rule is published in the Federal Register and permits eligible CPOs to adopt the monthly account statement reporting schedule 60 days after its publication.

On September 12, the Commodity Futures Trading Commission (CFTC or Commission) published a final rule, adopting amendments to CFTC Rule 4.7, which provides exemptive relief from certain compliance obligations to registered commodity pool operators (CPOs) and commodity trading advisers (CTAs) that offer pools or advisory services solely to qualified eligible persons (QEPs) (the Rule).¹ This marks the first amendments to Rule 4.7 in over 30 years.

The Rule (i) amends the definition of Portfolio Requirement by raising the monetary thresholds applied to prospective pool participants and (ii) provides CPOs operating as funds of funds the option to distribute account statements to pool participants on a monthly basis, within 45 days of month-end. In addition, the CFTC declined to finalize a proposed rule that would have amended Rule 4.7 to require registered CPOs that were previously exempt to make certain disclosures to pool participants.

Increased Portfolio Requirement Thresholds

As the CFTC explained in the Rule, it updated the monetary thresholds within the definition of Portfolio Requirement under Rule 4.7 to reflect the effects of inflation over the 32 years since the rule’s initial adoption. Pursuant to Rule 4.7(b)(2), CPOs that offer their pools exclusively to QEPs are exempt from certain disclosure and reporting requirements under Part 4 of the CFTC rules.² Prior to the Rule, to qualify as a QEP, a CPO or CTA needed to reasonably believe that a prospective pool participant met one of the following three monetary thresholds:³

1. **Securities Threshold:** Owned securities and other investments of non-affiliated issuers with an aggregate market value of at least \$2 million

2. **Margin Threshold:** Had on deposit with a futures commission merchant, for its own account, at least \$200,000 in exchange-specific initial margin and option premiums at any time during the six-month period preceding either (i) the date of the participant's purchase of an exempt pool or (ii) the date the participant opened an exempt account with a CTA
3. **Combined Threshold:** Owned a portfolio comprised of a combination of securities/investments and margin/premiums that equaled 100% of the two thresholds (e.g., \$1 million in securities and \$100,000 in initial margin)

The Rule increases these monetary thresholds: The Securities Threshold will be \$4 million and the Margin Threshold will be \$400,000. The Combined Threshold will remain an option within the Portfolio Requirement definition (i.e., \$2 million in securities and \$200,000 in initial margin will meet the Combined Threshold).

Once the new Portfolio Requirement thresholds are effective, any CPO or CTA with existing pool participants or advisory clients that do not satisfy the new thresholds need not redeem such persons' pool participations or terminate the advisory relationship with such persons. However, Rule 4.7 CPOs and CTAs may not sell any additional pool participations or open any additional advisory accounts for any investors/clients that do not meet the new Portfolio Requirement thresholds.

Monthly Account Statement Distribution for Funds of Funds

Under Rule 4.7(b)(3)(i), in accordance with Rule 4.22(h), registered CPOs are permitted to distribute account statements to pool participants quarterly, within 30 days after the end of the reporting period. As the CFTC noted in the proposed rulemaking for Rule 4.7, the Commission has routinely granted exemptive letter requests to Rule 4.7 CPOs that operate as funds of funds, permitting requesting CPOs to distribute monthly, rather than quarterly, account statements within 45 days of month-end.⁴

The Rule codifies these exemptive letter requests from funds of funds. Under the Rule, registered CPOs that operate as funds of funds may elect a monthly account statement distribution schedule, where the CPO must distribute statements within 45 days of month-end. If a CPO elects a monthly schedule, the statements must conform with the technical requirements of Rule 4.7(b)(3). The CPO must also notify pool participants of the alternate distribution schedule in the pool's offering memorandum or upon adoption of the schedule.

Unadopted Disclosure Requirements

Under Rule 4.7, registered CPOs and CTAs that offer pools or advisory services solely to QEPs are exempt from delivering general, risk, and performance disclosures to pool participants.⁵ The CFTC proposed amending Rule 4.7 to require CPOs to deliver a set of disclosures to prospective QEP pool participants. These disclosures would have included (i) principal risk factors, (ii) investment program details, (iii) use of proceeds, (iv) descriptions of custodians, (v) fees and expenses, (vi) conflicts of interest, and (vii) targeted past performance information. However, the Rule did not adopt those proposed disclosure requirements. Given that the comments it received were generally opposed to adding the new disclosure requirements, the Commission determined that it will take additional time to consider alternative disclosure amendments to Rule 4.7.

Our Thoughts

- The final rule is significantly less controversial than the proposed rule, as the CFTC has removed the previously suggested disclosure requirements that raised concerns among CPOs and CTAs.
- Private fund managers may need to update their fund documents, including subscription agreements, to reflect the revised Portfolio Requirement thresholds.

- Funds that rely on the exemption under Section 3(c)(7) of the Investment Company Act will still be able to qualify for the registered CPO and CTA exemptions under Rule 4.7.
- The changes to Rule 4.7 do not impact Rules 4.13 and 4.14, which provide exemptions from CPO and CTA registration, respectively, rather than offering a “registration light” alternative.

Next Steps

For more information, guidance, or clarification regarding the changes to Rule 4.7, please contact either the authors of this article or your usual Lowenstein Sandler representative.

¹ *Commodity Pool Operators, Commodity Trading Advisors, and Commodity Pools Operated under Regulation 4.7: Updating the ‘Qualified Eligible Person’ Definition; Adding Minimum Disclosure Requirements for Pools and Trading Programs; Permitting Monthly Account Statements for Funds of Funds; Technical Amendments*, Final Rule (Sept. 12, 2024).

² 17 C.F.R. § 4.7(b)(2).

³ Under Rule 4.7, a person can qualify as a QEP without satisfying the Portfolio Requirement thresholds if the CPO or CTA reasonably believes that the person is a futures commission merchant, swap dealer, retail foreign exchange dealer, broker dealer, CPO, CTA or investment advisor acting for its own account. 17 C.F.R. § 4.7(a)(2).

⁴ *Commodity Pool Operators, Commodity Trading Advisors, and Commodity Pools: Updating the ‘Qualified Eligible Person’ Definition; Adding Minimum Disclosure Requirements for Pools and Trading Programs; Permitting Monthly Account Statements for Funds of Funds; Technical Amendments*, Proposed Rule, 88 FR 70852, 70863 (Oct 12, 2023). The Commission defined funds of funds as “pools that invest in unrelated funds, pools, or other collective investment vehicles.” *Id.* at 88 FR at 70856, n 42.

⁵ See 17 C.F.R. §§ 4.7(b)(2) and (c)(1).

Contacts

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