

ALERTS

CFTC Increases Financial Thresholds for Qualified Eligible Person Status

September 18, 2024

On Sept. 12, 2024, the Commodity Futures Trading Commission (“CFTC”) adopted amendments (“Final Rule”)[1] to CFTC Rule 4.7, which is the primary disclosure, reporting and recordkeeping relief relied upon by CFTC-registered commodity pool operators (“CPOs”) and commodity trading advisors (“CTAs”). The Final Rule only partially adopted the proposals advanced by the CFTC nearly a year ago (“Proposal”). Importantly, the CFTC has elected to double the financial thresholds required for investors to be Qualified Eligible Persons (“QEPs”) suitable to invest in a Rule 4.7 pool or fund. However, the CFTC decided not to adopt the time-consuming and detailed disclosure requirements included in the Proposal. Operators of Section 3(c)(1) pools and funds that rely on Rule 4.7 will need to adjust their documents to accommodate the new QEP financial thresholds. We do not anticipate any substantive impact on operators of Section 3(c)(7) pools and funds.

Background

Almost one year ago[2], the CFTC proposed amendments to Rule 4.7 that, along with relatively minor technical changes, would have required vehicles and accounts relying on Rule 4.7 relief to provide extensive investor disclosures (including break-even fee and expense analysis per unit of participation, and historical performance), as well as doubled the thresholds of the financial test that must be met for certain persons to qualify as eligible participants in Rule 4.7 funds and accounts (“Portfolio Requirement”). As Rule 4.7 currently does not require delivery of a disclosure document at all, and several of the proposed disclosures were

unlikely to be included in managers' existing documents, the disclosure changes attracted particular attention from commenters (eight comment letters were received in total, including letters from the National Futures Association, SIFMA AMG and the Managed Funds Association, all of which advised against adopting the Proposal's mandatory disclosure requirements).

The Final Rule does not include the extensive mandatory disclosures included in the Proposal; although the CFTC has noted that it may revisit such changes in the future. The CFTC has, however, adopted its proposed amendments to the QEP Portfolio Requirement, along with codifying certain existing no action relief for account statement delivery and making minor "housekeeping" edits to Rule 4.7 to update rule cross-references. The Final Rule will be effective 60 days after publication in the Federal Register and the compliance date for the new Portfolio Requirement will be six months after publication.

Changes to the Portfolio Requirement

Updates to QEP Standard — Inflation Adjustment Increases to Portfolio Requirement Thresholds

The Final Rule adopts the CFTC's revised Portfolio Requirement as proposed, while clarifying the implementation period for these new thresholds. Note that not all investors in Rule 4.7 pools and funds will be affected by the revised Portfolio Requirement. QEPs fall into two categories: (i) those subject to a Portfolio Requirement as outlined in paragraphs (a)(1)(v) and (c)(3) of Rule 4.7 itself, and (ii) those exempt from complying with this test in view of some other status (most importantly, non-US Persons and Qualified Purchasers). This latter category of investors remains unchanged by the Final Rule. However, once effective, the revised Portfolio Requirement will double the financial thresholds for subject investors:

Asset Threshold: owning securities and other assets of the stipulated value

Deposit Threshold: having on deposit with a futures commission merchant own account at least the stipulated amount in initial margin, option premium security deposits.

As under the current definition, an investor may also satisfy the Portfolio Requirement by owning a portfolio of funds and assets that, when expressed as percentages of the prior two thresholds, have a combined value of at least 100 percent.

Effect of the Revised Portfolio Requirement

Aside from potential *pro forma* amendments to their subscription documents, managers who operate Section 3(c)(7) funds^[3] relying on CFTC Rule 4.7 will not be affected by the revised Portfolio Requirement. These funds collect Qualified Purchaser representations from their ordinary investors, and knowledgeable employees — a potential category of 3(c)(7) investor exempt from the Qualified Purchaser requirement under Rule 3c-5 — are also a category of QEP that is exempt from compliance with the Portfolio Requirement. Similarly, operators of Rule 4.13(a)(3) funds (whether relying on Section 3(c)(7) or 3(c)(1) SEC relief) are unlikely to be substantively affected by the new QEP thresholds, as the Rule 4.13(a)(3) exemption is satisfied by the Accredited Investor thresholds which are lower than those for the QEP definition.^[4]

Managers of Rule 4.7 Section 3(c)(1)^[5] vehicles will, however, need to adjust their offering documents to accommodate the revised Portfolio Requirement. As noted, the revised Portfolio Requirement will be effective six months after the Final Rule is published in the Federal Register. After that time, the CFTC has confirmed that managers of Section 3(c)(1) funds or accounts will not be required to redeem or terminate an advisory relationship with an existing investor that is unable to meet the new Portfolio Requirement. However, all future investments (including by existing investors) must occur in compliance with the new Portfolio Requirement once it is effective.

Other Changes

Codifying existing no action relief, the Final Rule also amends Rule 4.7 to explicitly permit funds of funds to choose an alternate monthly schedule for delivery of attested account statements. Under the current Rule, attested account statements must be provided to investors within no less frequently than quarterly, within 30 days of quarter end. As amended, Rule 4.7 permits managers of funds of funds to instead deliver these reports on a *monthly basis* within *45 days* of month end, provided that the account statements otherwise meet all of the requirements of Rule 4.7 and investors are informed about the alternate distribution schedule either in

fund's private placement memorandum delivered prior to an initial investment, or upon adoption of the alternate reporting schedule, for existing investors. This new mechanic will be available to Rule 4.7-compliant funds of funds once the Final Rule is effective; compliance with its terms is required upon election of the new schedule. Unlike the prior no action relief this amendment replaces, special notice to the CFTC is not required under this new provision.

Key Action Steps

Managers of Section 3(c)(1) vehicles relying on Rule 4.7 will need to ensure that they are prepared to 1) make necessary amendments to their subscription documents reflecting the revised QEP Portfolio Requirement and 2) collect updated QEP representations for any future investments subject to the revised Portfolio Requirement. It may be advisable to collect updated investor representations well in advance of the six-month effective date of the revised Portfolio Requirement. Managers of 3(c)(7) and other funds may wish to review their subscription documents for any necessary *pro forma* amendments.

Authored by *Daniel F. Hunter* and *Joshua B. Wright*.

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

[1] See 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 (Pre-Print), accessible [here](#).

[2] See *Schulte Alert: CFTC Proposes Rule 4.7 Changes That Would Impose Significant New Disclosure Requirements for Many CPO-Registered Fund Managers and CTA-Registered Advisers*, accessible [here](#).

[3] A Section 3(c)(7) fund is a pooled investment vehicle that is excluded from the definition of investment company in the Investment Company Act because it is limited to investors that are Qualified Purchasers and otherwise meets criteria outlined in Section 3(c)(7) of the Investment Company Act.

[4] The Accredited Investor thresholds and QEP Portfolio Requirement are not expressed in precisely identical terms, but all Accredited Investors are eligible to participate in Rule 4.13(a)(3) vehicles under CFTC Rule 4.13(a)(3)(iii)(A).

[5] A Section 3(c)(1) fund is a pooled investment vehicle that is excluded from the definition of investment company in the Investment Company Act because it has no more than 100 beneficial owners (or, in the case of a qualifying venture capital fund, 250 beneficial owners) and otherwise meets criteria outlined in Section 3(c)(1) of the Investment Company Act.

This communication is issued by Schulte Roth & Zabel LLP for informational purposes only and does not constitute legal advice or establish an attorney-client relationship. In some jurisdictions, this publication may be considered attorney advertising. © 2024 Schulte Roth & Zabel LLP. All rights reserved. SCHULTE ROTH & ZABEL is the registered trademark of Schulte Roth & Zabel LLP.

Related People



**Daniel
Hunter**

Partner
New York



**Joshua
Wright**

Associate
New York

Practices

Attachments

⬇ Download Alert