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CFTC Adopts Final Rules on CPO Registration and Compliance

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On February 9, 2012, the Commodity Futures Trading Commission ("CFTC") adopted final rules that will limit significantly the ability of advisers to private funds and registered investment companies to rely on existing exemptions and exclusions from CFTC regulation.[1] The final rules also will impose new filing and reporting requirements on certain advisers to funds that invest in commodity interests, including options on futures, security futures and swaps.

The final rules:

- rescind the exemption from registering as a commodity pool operator ("CPO") in CFTC Rule 4.13(a)(4), which is used by many advisers to private funds that invest in commodity interests; and
- narrow the exclusion from the definition of CPO relied upon by most investment advisers to registered investment companies that invest in commodity interests.
  Accordingly, a number of investment advisers that were previously exempt or excluded from registration as a CPO will need to register with the CFTC in the future. However, these CPOs may qualify under the *de minimis* exemption under CFTC Rule 4.13(a)(3) or under CFTC Rule 4.7 for partial exemptions from certain of the substantive requirements that apply generally to CPOs.

In addition, the final rules:

- require that certain exempt CPOs begin making annual notice filings with the CFTC to reaffirm their continued eligibility for the applicable exemption or exclusion;
- require that advisers that are registered with the CFTC as a CPO or commodity trading advisor ("CTA") begin making filings on the new Forms CPO-PQR and CTA-PR, respectively, with respect to the commodity pools they direct; and
- provide that CPOs and CTAs registered with the CFTC must begin including a standardized risk disclosure statement regarding swaps in disclosure documents for pools and clients that may engage in swaps.

Rescission of Rule 4.13(a)(4)

The final rules rescind the exemption from registration as a CPO provided in Rule 4.13(a)(4) of the Commodity Exchange Act ("CEA"). This was the exemption relied upon by many investment advisers (and their affiliates) when operating private funds that invest in commodity interests (which, as noted above, includes security futures and now swaps). Rule 4.13(a)(4) exempted from registration as a CPO the operator of a commodity pool offered only to individuals and entities that satisfy the qualified eligible person standard in Rule 4.7 of the CEA or the accredited investor standard of Regulation D of the Securities Exchange Act of 1934. Since most investors in private funds satisfy these criteria, advisers to private funds have readily relied upon Rule 4.13(a)(4) historically.

Advisers may continue relying upon the exemption in Rule 4.13(a)(4) for their existing private funds until December 31, 2012. However, for any new fund that commences business on or after a date at least 60 days from publication of the final rules in the federal register (which is expected shortly), such adviser must either register as a CPO, or rely on an alternative exemption or exclusion from the time of the new fund's launch.

With the rescission of the Rule 4.13(a)(4) exemption, many advisers to private funds will need to consider whether they qualify for another exemption and if not, will be required to register as CPOs. Advisers currently managing private funds that have claimed the exemption in Rule 4.13(a)(4) should determine whether their funds are able to rely on the *de minimis* exemption provided in Rule 4.13(a)(3) (described below). This analysis must take into account swaps, which are proposed to be included in the definition of "commodity interest" and therefore expected to apply toward the *de minimis* threshold.[2]

Retention of Rule 4.13(a)(3)

The *de minimis* exemption in Rule 4.13(a)(3) was initially proposed to be rescinded along with Rule 4.13(a)(4) in the January 26, 2011 CFTC proposing release.[3] However, only Rule 4.13(a)(4) was rescinded in the final rules, and the exemption in Rule 4.13(a)(3) has been retained with minor amendments.

The exemption in Rule 4.13(a)(3) is available to the CPO of a pool with commodity interest positions that either have a net notional value not exceeding 100% of the portfolio's liquidation value or that have been established with aggregate initial margin and premiums not exceeding 5% of the portfolio's liquidation value (in both cases, as measured at the time the most recent position was established).

CPOs currently relying upon the exemption in Rule 4.14(a)(4), that instead intend to rely upon the exemption in Rule 4.13(a)(3), may make the change whenever they satisfy the criteria of Rule 4.13(a)(3) by amending their existing Notice of Exemption through the National Futures Association's ("NFA") electronic filing system. There is no need to wait for the effective date or compliance dates of the final rules.

Assuming an adviser currently relying upon the exemption in Rule 4.13(a)(4) for its existing private funds is unable to rely on the *de minimis* exemption with respect to all of its funds it would likely be required to register as a CPO and a CTA.

Amendment of Rule 4.5

The final rules include amendments to Rule 4.5 of the CEA that narrow the exclusion from the definition of CPO used by most advisers to registered investment companies invested in commodity futures, commodity options and swaps. The amendments to Rule 4.5 include the reinstatement of a 5% trading threshold test (formerly rescinded in 2003), the addition of an alternative net notional *de minimis* test (similar to that existing in Rule 4.13(a)(3)), and the addition of a marketing restriction. As amended, the exclusion from the definition of CPO will be available only to advisers of registered investment companies with positions in commodity futures, commodity options or swaps that either have a net notional value not exceeding 100% of the liquidation value of the portfolio or that have been established with aggregate initial margin and premiums not exceeding 5% of the liquidation value of the portfolio. Any commodity futures, commodity options or swaps entered into by the registered investment company for bona fide hedging purposes need not be counted towards the *de minimis* or 5% trading thresholds under Rule 4.5 (though they are counted under Rule 4.13(a)(3)). The exclusion from the definition of CPO is further conditioned on the registered investment company not being marketed as a vehicle for exposure to trading in the commodity futures, commodity options or swaps markets.

Advisers previously relying upon Rule 4.5 that are no longer eligible to do so will be required to register with the CFTC by the later of December 31, 2012 or 60 days after the adoption of final rules defining the term "swap." Notwithstanding such registration as a CPO, these advisers will not be required to comply with the full CFTC compliance regime set forth in Part 4 of CFTC regulations until 60 days after the adoption of final rules harmonizing the compliance obligations in Part 4 with those of the SEC for registered investment companies. The notice of proposed rulemaking detailing the harmonizing modifications to Part 4 was issued concurrently with the final rules on February 9, 2012.[4]

Registration Process and Timing

Registration as a CPO and/or a CTA typically takes from six to eight weeks to complete. The process involves completing a "Firm Application" on Form 7-R (which includes basic company information and disciplinary records) and a Membership Application with the NFA, as well as "Individual Applications" on Form 8-R for each "Associated Person" and "Principal" together with a fingerprint card. In addition, each Associated Person must have passed the National Commodity Futures Exam (Series 3) within the past two years or an alternative examination, such as the Series 31, or be eligible for a waiver.

Most advisers currently relying on the exemption in Rule 4.13(a)(4) would be eligible to rely on CFTC

Rule 4.7. Rule 4.7 provides relief from certain disclosure, recordkeeping and reporting requirements for CPOs that offer interests in private funds investing in commodities solely to "qualified eligible participants." The definition of "qualified eligible participants" encompasses the definition of "qualified purchasers" and, therefore, is available to private funds that are excluded from the definition of "investment company" under Section 3(c)(7) of the Investment Company Act of 1940.

Most advisers to registered investment companies currently relying on the exclusion in Rule 4.5 likely would not be eligible for the relief under CFTC Rule 4.7, because most registered investment companies are not offered exclusively to "qualified eligible participants."

Annual Notice Filings

The final rules adopt new filing requirements for each adviser relying on an exemption from registration as a CPO under Rule 4.13(a)(3) or exclusion from the definition of CPO under Rule 4.5. The filings will be due annually after each calendar year end and require a representation from the adviser reaffirming its eligibility for such exemption or exclusion.

Annual notice filings will first be due for the calendar year ending December 31, 2012. Advisers relying on an exemption from registration as a CPO under Rule 4.13(a)(3) must file the Notice of Exemption within 60 days of calendar year end. Advisers relying on the exclusion under Rule 4.5 must file a Notice of Exclusion within 30 days of calendar year end. Filings will be made through the NFA's electronic filing system.

New Reporting Requirements for Registered CPOs and CTAs

The final rules include adoption of Rule 4.27 of the CEA, which will require CPOs and CTAs that are registered with the CFTC (including CPOs registered with the CFTC but relying on Rule 4.7) to make periodic filings on new Forms CPO-PQR and CTA-PR, respectively, regarding the commodity pools (funds) they manage.

All CTAs registered with the CFTC must file Form CTA-PR annually within 45 days of fiscal year end. The filing obligations of CPOs registered with the CFTC vary depending on the size of the CPO and its other filing obligations on Form PF. If the aggregate amount of assets under management by a CPO attributable to commodity pools equals or exceeds $150 million or $1.5 billion, such CPO will be deemed a mid-sized CPO or large CPO, respectively. A mid-sized CPO must file Schedules A and B of Form CPO-PQR annually, within 90 days of the close of each calendar year in which the CPO qualified as a mid-sized CPO. A large CPO must file Schedules A, B and C of Form CPO-PQR quarterly, within 60 days of the end of each calendar quarter in which it qualified as a large CPO. All other registered CPOs are required to file Schedule A of Form CPO-PQR annually, within 90 days of the end of each calendar year in which it was registered as a CPO.

As an alternative to filing Schedules B and C of Form CPO-PQR, a large or mid-sized CPO may fulfill its obligations to file such schedules by properly filing a Form PF with the SEC as required by Rule

204(b)-1 under the Investment Advisers Act of 1940 with certain additional information about the commodity pools it operates, including those pools that may not qualify as private funds. The filing of Form PF does not relieve a large or mid-sized CPO of the obligation to file Schedule A of Form CPO-PQR.

Large CPOs with assets under management attributable to commodity pools of at least $5 billion (measured at the last fiscal quarter end preceding September 15, 2012) must make their first filings on Form CPO-PQR within 60 days following September 30, 2012. All other CPOs and CTAs registered with the CFTC must begin complying with the new reporting requirements by December 14, 2012. Accordingly, most CPOs and CTAs will make their first filings on Forms CPO-PQR and CTA-PR within 90 days following December 31, 2012.

Addition of New Swap Risk Disclosure for Registered CPOs and CTAs

The final rules require that registered CPOs and CTAs include standardized risk disclosure concerning swaps in the mandatory risk disclosure statement already required under Commission Rules 4.24(b) and 4.34(b). The new standardized swap disclosure must be included in the disclosure document of each commodity pool or program that may engage in swaps and should be in addition to, not in place of, the more tailored disclosure of actual risks of investing in swaps applicable to a given pool or program, as required by Rules 4.24(g) and 4.34(g). Registered CPOs and CTAs must include the standardized swap disclosure in all new disclosure documents and updates filed on or after a date at least 60 days from publication of the final rules in the federal register (which is expected shortly), for pools and programs that may engage in swaps. These disclosures do not apply to CPOs relying on Rule 4.7.

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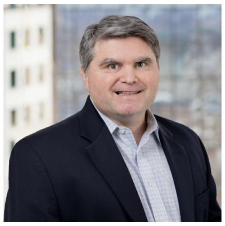
[1] Available at: http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister020912b.pdf

[2] It should be noted that the definition of "swaps" does not include securities based swaps.

[3] 76 FR 7976 (February 11, 2011). Available at: http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-2437a.pdf

[4] Available at: http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister020912.pdf

Authors



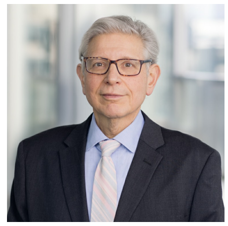
Timothy F. Silva

PARTNER

Chair, Investment Management Practice

timothy.silva@wilmerhale.com

+1 617 526 6502



Paul M. Architzel

RETIRED SENIOR COUNSEL

+1 202 663 6000

Gretchen Passe Roin

PARTNER

gretchen.roin@wilmerhale.com

+1 617 526 6787