CFTC Adopts Final Rule Amendments Regarding Registration and Reporting Requirements for CPOs and CTAs and Issues Regulatory Harmonization Proposal

CFTC’s New Rules Rescind and Amend Certain Existing Exemptions and Exclusions, Require Advisers to Many Private Funds to Register with the CFTC, and Significantly Limit the Ability of Registered Investment Companies to Claim Exclusion from the Definition of CPO; Proposed Rule Amendments Seek to Harmonize Certain SEC and CFTC Compliance Obligations of CPOs of Registered Investment Companies

SUMMARY

On February 9, 2012, the CFTC adopted rule amendments that will, among other things, require registration of certain entities that are currently eligible for exemptions from registration as CPOs and CTAs.¹ The February 9, 2012 adopting release (the “Adopting Release”) implements, with certain limited modifications, proposals issued by the CFTC in January 2011² to amend significantly its rules regarding CPOs and CTAs. The rule amendments approved by the CFTC will also require CPOs and CTAs to file reports regarding commodity pool and certain other assets under their management. The revised rules will increase disclosure requirements for both newly registered and existing CPOs and CTAs and will require more information to be made available to prospective investors and for use in risk assessment by the Financial Stability Oversight Council. In particular, the revised rules will:

- significantly limit the availability of the exclusion from the CPO definition pursuant to Section 4.5 of the CFTC’s rules (the exclusion relied upon by numerous registered investment companies and other regulated entities);
mandate annual affirmation of exemptive relief claims for both CPOs and CTAs that rely on either Section 4.5 or Section 4.13(a)(3) to avoid CFTC registration;

require the filing of certified annual reports by all registered CPOs;

rescind the exemption from CPO registration under Section 4.13(a)(4) of the CFTC’s rules, which operators of many private funds have relied on historically;

require CPOs and CTAs that use swaps to add standard risk disclosure statements regarding their use of swaps to all new disclosure documents and all updates to existing disclosure documents; and

require periodic reporting of data by CPOs and CTAs regarding their commodity pool assets and other managed assets.

The Adopting Release reflects certain limited changes from the CFTC’s January 2011 proposals. In particular, the CFTC:

modified the proposed marketing restriction and included an alternative trading threshold test in Section 4.5;

provided for annual notices affirming exemptive relief claims to be filed on a calendar year-end basis rather than on the anniversary of the filing of the initial claim;

determined not to rescind Section 4.13(a)(3), which exempts from registration CPOs of pools with a “de minimis” amount of derivatives trading; and

made changes to Forms CPO-PQR and CTA-PR including expanding the number of sections of such forms that will be confidential and modifying their filing timelines.

Concurrently, and in response to comments, the CFTC proposed rule amendments to harmonize SEC and CFTC disclosure, reporting and recordkeeping requirements that apply to registered investment companies that are not excluded from the definition of CPO and thus are subject to both SEC and CFTC requirements (the “Harmonization Proposal”). Comments on the Harmonization Proposal are due 60 days after publication of the proposed rules in the Federal Register.

CFTC REGISTRATION OF COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISERS

REGULATORY BACKGROUND

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) amended the Commodity Exchange Act (the “CEA”) to define a commodity pool as “any investment trust, syndicate, or similar form of enterprise operated for the purpose of trading in commodity interests, including any… commodity for future delivery, security futures product, or swap.” Prior to the Dodd-Frank amendments, the term “commodity interests” referred primarily to futures contracts and options thereon and did not include swaps. As numerous funds have utilized swaps for many years, the effect of this amendment was to increase significantly the level of “commodity interests” in funds, thereby making it more likely that the relevant entities will become subject to CPO and CTA registration and regulation.
Any entity that operates a commodity pool must register with the CFTC as a commodity pool operator ("CPO"), absent an available exemption. Similarly, a person that, for compensation or profit, engages in the business of advising others, including commodity pools, regarding, among other things, futures contracts or commodity option trading (and as a result of Dodd Frank, its swap transactions) must register with the CFTC as a commodity trading advisor ("CTA"). Historically, registered investment companies have relied on the exclusion from the definition of CPO provided by Section 4.5 and their advisers have relied upon the exemption from registration as a CTA pursuant to Section 4.14(a)(8)(i)(A). Many investment advisers have also relied upon the exemption from CPO registration provided by Section 4.13 in respect of their advice to unregistered funds that utilize commodity interests.

Section 4.5 provides a conditional exclusion from the definition of CPO for certain entities that are regulated under other regulatory regimes, and Section 4.14(a)(8) provides an exemption from CTA registration to investment advisers that provide commodity trading advice solely to, among others, entities that have claimed the exclusion pursuant to Section 4.5. Section 4.13(a)(3) provides a "de minimis" exemption from registration as a CPO to entities that meet certain requirements. Section 4.13(a)(4) currently provides an exemption from registration as a CPO for entities that operate commodity pools whose interests are not registered under the Securities Act of 1933, as amended (the "Securities Act") and whose participants are "qualified eligible persons," as defined in Section 4.7(a)(2), and/or "accredited investors," as defined in the rules under the Securities Act. Similarly, Section 4.14(a)(8) currently exempts advisers of exempt pools from registration as CTAs, including advisers to pools relying on the exemptions pursuant to Sections 4.13(a)(3) and (a)(4).

Although Dodd-Frank imposed an explicit statutory requirement that investment advisers to large private funds (namely, hedge and private equity funds) register with the SEC and make certain periodic reports to the SEC, Dodd-Frank did not require the CFTC to amend its registration criteria and reporting requirements for CPOs and CTAs. In the Adopting Release, the CFTC stated that "[t]he sources of risk delineated in the Dodd-Frank Act with respect to private funds are also presented by commodity pools" and explained that it was adopting the revised rules on its own initiative to increase transparency and restore parity between the SEC and CFTC registration rules. Throughout the Adopting Release, the CFTC emphasized the similar functions of new Forms CPO-PQR and CTA-PR and recently adopted Form PF, which the SEC and CFTC adopted under the Investment Advisers Act of 1940 and the CEA in 2011. The SEC and CFTC rules adopting Form PF require certain SEC-registered investment advisers that advise at least one "private fund" (i.e., hedge or private equity fund) and certain CPOs and CTAs that manage at least one commodity pool that is a "private fund" and, therefore, are registered with the SEC as investment advisers or required to be so registered with the SEC, to report periodically certain identifying and operational information to the SEC on Form PF.
CHANGES TO REGISTRATION REQUIREMENTS AND EXEMPTIONS

SECTION 4.5 EXCLUSIONS FROM THE DEFINITION OF CPO

The amendments to Section 4.5 significantly restrict its availability, and are expected to result in a significant number of registered investment companies no longer qualifying for its exclusion from the definition of CPO. The revisions to the rule respond to a petition from the National Futures Association ("NFA") which requested the CFTC adopt regulations to limit and monitor certain registered investment companies that were perceived to be offering de facto commodity pool interests in reliance on the Section 4.5 exclusion.\(^8\) As amended, Section 4.5 conditions the exclusion on an entity limiting its use of commodity interests, other than for bona fide hedging purposes, below one of two alternative thresholds—a trading threshold and an alternative net notional value threshold.\(^9\) The trading threshold parallels the trading test in Section 4.13(a)(3)(ii)(A), while the alternative net notional value threshold is identical to the net notional value test described in Section 4.13(a)(3)(ii)(B). Significantly, entities seeking to rely on the Section 4.5 exclusion may utilize futures, options or swaps for bona fide hedging purposes to an unlimited extent. Bona fide hedging positions are not excluded when making computations under Section 4.13(a)(3)(ii)(B).

Under amended Section 4.5, if a person claiming the Section 4.5 exclusion is a registered investment company, such person’s notice of eligibility for the Section 4.5 exclusion must contain representations that it will either:

- use commodity futures or commodity options contracts or swaps solely for bona fide hedging purposes (as defined in Sections 1.3(z)(1) and 151.5 of the CFTC’s rules\(^10\)), provided that with respect to positions in commodity futures or commodity option contracts or swaps that are not for bona fide hedging purposes, it will not allow the aggregate initial margin and premiums required to establish such positions to exceed five percent of the liquidation value of its portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into;\(^11\) or
- not allow the aggregate net notional value of commodity futures, commodity options contracts or swaps positions that are not used solely for bona fide hedging purposes to exceed 100 percent of the liquidation value of the commodity pool’s portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into.

Commenting on the definition of “notional value” in amended Section 4.5, the CFTC stated in the Adopting Release that “[n]otional value is defined by asset class. For example, the notional value of futures contracts is derived by multiplying the number of contracts by the size of the contract, in contract units, and then multiplying by the current market price for the contract.”\(^12\) The CFTC did not increase the de minimis thresholds to account for the inclusion of swaps in the definition of commodity interests but amended Section 4.5 provides that the notional value of a cleared swap is determined consistent with the provisions of Part 45 of the CFTC’s regulations and that swaps cleared by the same derivatives clearing organization may be netted where appropriate.\(^13\)
Amended Section 4.5 also imposes a marketing test for any registered investment company claiming exclusion from the definition of CPO that requires the entity to include in its notice of eligibility a representation that it will:

- not be, and not have been, “marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in the commodity futures, commodity options, or swaps markets.”

Significantly, and in response to comments, the CFTC removed the parenthetical statement “(or otherwise seeking investment exposure to)” after “trading in” from the marketing restriction citing the “unacceptable level of ambiguity” that the clause created.14

In the Adopting Release, the CFTC indicated that it wishes to ensure that any entity operating a de facto commodity pool, by virtue of now having to register as a CPO, will be subject to CFTC oversight and also required to report the activities of such pools on Form CPO-PQR. Additionally, the CFTC offered guidance on how it will evaluate whether an entity has violated the marketing restriction in Section 4.5 and provided an instructive list of factors, none of which would be dispositive, that it would consider in such an evaluation:

- the name of the fund;
- whether the fund’s primary investment objective is tied to a commodity index;
- whether the fund makes use of a controlled foreign corporation (“CFC”) for its derivatives trading;
- whether the fund’s marketing materials, including its prospectus or disclosure document, refer to the benefits of the use of derivatives in a portfolio or make comparisons to a derivatives index;
- whether, during the course of its normal trading activities, the fund or any entity acting on its behalf has a net short speculative exposure to any commodity through a direct or indirect investment in other derivatives;
- whether the futures, options and/or swaps transactions engaged in by the fund or on behalf of the fund will directly or indirectly be its primary source of potential gains and losses; and
- whether the fund is explicitly offering a managed futures strategy.15

The CFTC noted that many registered investment companies have invested up to 25% of their assets in wholly owned non-U.S. subsidiaries that engage in commodity interest transactions and that operators of these CFCs have been exempt from registration as CPOs under Section 4.13(a)(4), which is being repealed. The CFTC also noted that a number of commenters had urged that such exemptions be continued. The CFTC indicated that it does not oppose the use of CFCs for trading in commodity interests by registered investment companies, but that their operators must register as CPOs unless an exemption or exclusion is available. Given the nature of the activities of such CFCs, no such exemptions or exclusions will normally be available.
SULLIVAN & CROMWELL LLP

In the Adopting Release, the CFTC agreed with numerous commenters that the investment adviser to a registered investment company that is a commodity pool, rather than the investment company itself or the directors or trustees of the registered investment company, is the entity required to register as the investment company’s CPO.

SECTION 4.13(a)(3) AND 4.13(a)(4) EXEMPTIONS FROM CPO REGISTRATION

In its January 2011 proposals, the CFTC proposed rescinding both Sections 4.13(a)(3) and (a)(4). In the Adopting Release, the CFTC determined to retain the de minimis exemption from registration as a CPO in Section 4.13(a)(3) but to rescind Section 4.13(a)(4) which will require registration as CPOs of the operators of many private funds. Pursuant to Section 4.14(a)(4), a CPO that provides commodity interest trading advice exclusively to commodity pools operated by it is exempt from the requirement to register with the CFTC as a CTA.

Like Section 4.5, Section 4.13(a)(3) provides two tests, a trading test and an alternative net notional value test, and satisfaction of either test exempts an entity from registration as a CPO. Under the trading test, in general, aggregate initial margin and premiums required to establish commodity interest positions exceeding five percent of the liquidation value of a portfolio, after taking into account unrealized profits and losses, will be deemed to exceed the de minimis test. The net notional value test states that if the net notional value of commodity interest positions exceeds 100 percent of the liquidation value of a portfolio, the portfolio will be deemed to exceed the de minimis test. Please see the discussion of “notional values” under “Section 4.5 Exclusions From the Definition of CPO” above.

The CFTC rescinded Section 4.13(a)(4) and, referring to recent SEC regulatory amendments directed to promote transparency and increase regulation of private funds, reaffirmed its position that rescinding Section 4.13(a)(4) will “limit regulatory arbitrage through harmonization of the scope of [the CFTC’s] data collection with respect to pools that are similarly situated to private funds.”

The CFTC declined to address requests from commenters that it provide explicit exemptions for foreign advisors, family offices and funds of funds. The CFTC elected to withhold consideration of such exemptions until it has reviewed data collected on new Forms CPO-PQR and CTA-PR (discussed below). In the case of family offices, the CFTC stated that it was directing the CFTC staff “to look into the possibility of adopting a family office exemption in the future” and noted that “family offices continue to be permitted to write in on a firm by firm basis to request interpretative relief from the registration and compliance obligations under the [CFTC’s] rules and to rely on those interpretative letters already issued to the extent permissible under the [CFTC’s] regulations.”
CFTC REGISTRATION, REPORTING AND DISCLOSURE REQUIREMENTS

REGISTRATION OVERVIEW

To become a registered CPO or CTA, a person is required to make certain filings with the CFTC and the NFA and to provide certain disclosures to regulators and investors. In particular, persons required to register as either CPOs or CTAs must complete and file with the NFA a Form 7-R, which requests identifying and background information, as well as information about disciplinary issues. Registrants must also file a Form 8-R, which requests information similar to that required by Form 7-R, for each of their associated persons and principals, as applicable. Subject to certain exceptions, these associated persons and principals must also file fingerprint cards with the NFA, and associated persons and certain other individuals, such as branch managers, must also pass examinations to demonstrate proficiency in specific areas. In addition to providing this basic information in connection with registration, CPOs and CTAs must comply with various disclosure, reporting and recordkeeping obligations imposed by the CFTC under Part 4 of its rules.

Registered CPOs and CTAs are required to provide prospective pool participants and advisory clients, respectively, with a comprehensive disclosure document that must be filed in advance for review by the NFA, and must include specified information such as the background of the CPO or CTA, risk factors, past trading performance records and information related to fees and expenses. In addition to this disclosure document, CPOs must generally provide monthly financial reports and annual reports to pool participants. Further, CPOs and CTAs are required to maintain and retain certain records, which are subject to inspection by regulators and, in some cases, investors or clients.

NEW REPORTING AND DISCLOSURE REQUIREMENTS UNDER SECTION 4.27

The CFTC adopted two new disclosure forms, Forms CPO-PQR and CTA-PR, that must be completed pursuant to Section 4.27 by each CPO and CTA, respectively, that is either registered or required to be registered with the CFTC.

The CFTC will use Forms CPO-PQR and CTA-PR to gather basic information about registered CPOs and CTAs and to increase transparency in the markets it regulates. The new CFTC forms serve a purpose similar to the SEC’s recently adopted Form PF and request information similar to the information collected on Form PF. Because of the overlap in the requirements of Form PF and Form CPO-PQR, the CFTC will not require entities that file Form PF to complete the most detailed sections of Form CPO-PQR. This exemption relieves large dual registrants (as categorized by the forms) from filing anything other than general identifying information with the CFTC.

Form CPO-PQR has three schedules which CPOs must complete if they meet specified assets under management thresholds and if they do not file Form PF with the SEC. As with Form PF, the information required by the new CFTC form will vary depending on both the size of the CPO and the size of the pools.
it advises, based on the premise that larger CPOs are more likely to present greater risk to the financial
stability of the markets. All registered CPOs, even those that file Form PF, will be required to file
Schedule A to Form CPO-PQR. Schedule A to Form CPO-PQR requests generally the same information
that the NFA currently collects through Form PQR for CPOs and consists of general identification
questions. CPOs with assets under management equal to or greater than $150 million but less than $1.5
billion (so-called “mid-size CPOs”) will be required to file Schedule B to Form CPO-PQR to provide
additional information about the commodity pools they operate. CPOs with assets under management
equal to or greater than $1.5 billion (so-called “large CPOs”) will also have to file Schedule C to Form
CPO-PQR to provide aggregated information about pools they operate as well as information about
commodity pools with a net asset value exceeding $500 million. However, CPOs, regardless of size, that
file Form PF will not have to complete Schedule B or C to Form CPO-PQR.

Form CPO-PQR filing timelines also vary according to assets under management. All CPOs, other than
large CPOs, must file Schedule A on an annual basis. Mid-size CPOs must file Schedule B on an annual
basis and large CPOs must file Schedules A, B and C on a quarterly basis. All CPOs, other than large
CPOs, must file Schedule A and mid-size CPOs must file Schedule B within 90 days of the end of each
calendar year. Large CPOs must file Schedules A, B and C within 60 days following the end of the
reporting period.

Like Schedule A to Form CPO-PQR, Schedule A to Form CTA-PR consists of limited questions regarding
the identity and assets under management of the CTA. The CFTC did not adopt proposed Schedule B to
Form CTA-PR so that the form, as adopted, requests only limited identification data and information
regarding the pools advised by the CTA.

All CTAs required to file Form CTA-PR must do so annually within 45 days of the end of the fiscal year.

The three schedules to Forms CPO-PQR and CTA-PR require the following information:

1. Form CPO-PQR:
   - Schedule A requests background information, including:
     - Basic identifying information about the CPO, including its name, NFA identification
       number, and the CPO’s assets under management;
     - Information regarding each of the CPO’s pools, including names and NFA
       identification numbers, position information for positions comprising five percent or
       more of each pool’s net asset value, and the pool’s key relationships with brokers,
       etc.;
     - Identification of each operated pool’s carrying brokers, administrators, trading
       managers, custodians, auditors, and marketers;
     - Information regarding a pool’s subscriptions and redemptions, and any restrictions on
       them; and
CFTC Adopts Final Rule Amendments Regarding Registration and Reporting Requirements for CPOs and CTAs and Issues Regulatory Harmonization Proposal

February 22, 2012

- For funds of funds, basic identifying information about the names of investee funds and the size of a fund of funds’ investment in the investee fund.

- Schedule B requests detailed information for all operated pools, including information regarding:
  - Each pool’s investment strategy;
  - The identities of significant creditors and borrowings by geographic area;
  - Credit counterparty exposure; and
  - Entities through which the pool trades and clears its positions.

- Schedule C requests both aggregated information on all advised commodity pools and specific information on larger pools, including:
  - Certain aggregate information about the advised commodity pools, such as the market value of assets invested in different types of securities and derivatives, turnover in these categories of financial instruments, and the tenor of fixed income portfolio holdings; and
  - Certain information about any advised commodity pool with a net asset value of at least $500 million as of the end of any business day during the reporting period, such information to include information similar to the aggregated information referred to above, as well as additional information concerning the pool’s assets and positions, data regarding the commodity pool’s risk metrics, impact on the pool’s portfolio when stressing certain identified market factors, certain financing information and information about the reportable pool’s investor composition and liquidity.

2. Form CTA-PR

- Schedule A requests, among other things, general information about the CTA and the commodity pool and certain other assets under management by that CTA, including:
  - The name of the CTA and its NFA identification number;
  - The number of offered trading programs and whether any pool assets are directed under those trading programs;
  - The total assets directed by the CTA, as well as the total pool assets directed by the CTA; and
  - Identifying information about the pools under its advisement.

The CFTC adopted amendments to its rules to help ensure that certain proprietary information will be kept confidential. Specifically, for purposes of the Freedom of Information Act, the CFTC will treat the following as non-public records (and, thus, protected from public disclosure): (i) all of Schedules B and C to Form CPO-PQR; (ii) portions of Schedule A to Form CPO-PQR (including information about a pool’s distribution and marketing channels), and (iii) portions of Schedule A to Form CTA-PR. Similarly, the CFTC is proposing to exempt the same schedules, or portions thereof, from disclosure pursuant to the Government in the Sunshine Act.
OTHER AMENDMENTS TO PROMOTE TRANSPARENCY AND MONITOR RISK
FINANCIAL STATEMENTS CONTAINED IN COMMODITY POOL ANNUAL REPORTS
The CFTC rescinded the exemption provided in Section 4.7(b)(3) from the requirement that financial statements contained in commodity pool annual reports be certified by certified public accountants under Section 4.22(c). In the Adopting Release, the CFTC noted that, although it was rescinding the exemption for all pools, it would consider requests for exemptive relief on a case-by-case basis.

ANNUAL NOTICES FOR CONTINUED EXEMPTIVE OR EXCLUSIONARY RELIEF
In order to promote transparency and permit the CFTC to monitor the number of exempt entities operating in any year, the CFTC has adopted a requirement that all entities relying on a claim of exemption or exclusion from registration as a CPO or CTA file an annual reaffirmance within 60 days of the end of each calendar year. The annual reaffirmance filings must be made in each year after an entity files an initial claim for relief from registration.

NEW REQUIREMENT FOR RISK DISCLOSURE STATEMENT FOR CPO AND CTA USE OF SWAPS
The CFTC determined to adopt standard risk disclosure statements for CPOs and CTAs regarding their use of swaps. The disclosure statements, which take a “one size fits all approach” similar to that which has historically been used in connection with risk disclosure for futures transactions, caution investors about the significant risks involved in an investment in swaps, highlighting market risk, credit risk, counterparty credit risk, funding risk, liquidity risk and operational risk.

COMMISSIONER SOMMERS’ DISSenting STATEMENT
Commissioner Jill Sommers dissented from the CFTC’s vote to adopt the amended rules and explained that the amendments go “far beyond what was needed to resolve NFA’s concerns” articulated in its petition to reinstate certain operating restrictions that were in place prior to 2003 for entities excluded from the definition of CPO under Section 4.5. Commissioner Sommers also rejected the policy basis of the amendments asserting that “there is no evidence to suggest that inadequate regulation of commodity pools was a contributing cause of the [financial crisis of 2007 and 2008], or that subjecting entities to a dual registration regime will somehow prevent a similar crisis in the future.” Specifically, she does not agree with the CFTC’s distinction between risk mitigation positions and bona fide hedging transactions, the permission to exclude bona fide hedging transactions from the measure of aggregate net notional value under Section 4.5 with no parallel permission under Section 4.13(a)(3), the decision not to exempt foreign advisors from registration and the apparently inconsistent treatment of family offices. Finally, Commissioner Sommers expressed her view that the cost-benefit analysis supporting the amendments is unlikely to withstand judicial scrutiny if challenged.
PROPOSED RULES TO HARMONIZE COMPLIANCE OBLIGATIONS FOR ADVISORS TO REGISTERED INVESTMENT COMPANIES

The CFTC received numerous comments on its proposed amendments to Section 4.5 noting that sponsors of registered investment companies that no longer qualified for exclusion from the definition of CPO would be subject to “duplication, inconsistent and possibly conflicting disclosure and reporting requirements.” Commenters suggested that the SEC and CFTC requirements be harmonized. Concurrent with its adoption of amendments to Section 4.5, the CFTC released the Harmonization Proposal to amend certain CFTC requirements to harmonize SEC and CFTC compliance frameworks.

The CFTC proposes amending certain reporting and recordkeeping requirements that apply to registered investment companies that do not qualify for an exclusion from the definition of CPO. Sections 4.21, 4.22 and 4.23 impose certain reporting and recordkeeping requirements on CPOs. Section 4.21 requires a CPO that is registered or required to be registered with the CFTC to deliver a disclosure document to each prospective participant in any pool that it operates. Section 4.22 requires such CPOs to distribute account statements on a monthly basis to each participant in any pool that it operates. Finally, Section 4.23 requires a CPO to retain specified books and records at its main office. The CFTC recently adopted Section 4.12(c) to provide exemptive relief from Sections 4.21, 4.22 and 4.23 for CPOs that operate publicly offered commodity pools that are listed on national securities exchanges (“commodity ETFs”) that permits such CPOs to comply with Sections 4.21 and 4.22 by making documents available on the internet and to comply with Section 4.23 by hiring third-party, remotely located document retention and maintenance services. In order to be eligible for this exemptive relief, CPOs of commodity ETFs must file certain information and make certain representations to the CFTC in a notice claiming relief. The CFTC proposes extending the exemptive relief for CPOs that operate commodity ETFs under Section 4.12(c) to registered investment companies. Since the securities of most registered investment companies are not listed on a national securities exchange, the CFTC proposes to revise Section 4.12(c) to eliminate the requirement the exchange listing requirement. As proposed, the exemptions would be available in respect of pools: (i) whose units of participation are offered and sold pursuant to an effective registration statement under the Securities Act; or (ii) registered under the Investment Company Act.

The CFTC also proposes relief to conform the substance of SEC and CFTC required disclosures. Specifically, the CFTC suggests that the CPO of a registered investment company meet its requirement that any commodity pool that has traded commodity interests for less than three years must present the performance of certain other pools and accounts by including the disclosure in their Statements of Additional Information. Additionally, the CFTC recommends that registered investment companies utilize a cautionary statement in their prospectuses that meets the requirements of both the SEC and CFTC and proposes that, with respect to disclosure of an open-end registered investment company’s “break-event point” under Section 4.24, it will consider the forepart of the offering document to be the
section immediately following all disclosures required by SEC Form N-1A to be included in the summary prospectus. The CFTC also proposes, by amending Sections 4.26 and 4.36, to require CPOs and CTAs to file updates of all disclosure documents on an annual (rather than nine-month) basis to conform to the SEC’s annual update requirement. Finally, the CFTC volunteers that it will accept the certification required by the SEC in Form N-CSR to satisfy the certification requirement of Section 4.22(h) of its rules. The CFTC is seeking comments on all the above proposals. Comments are due 60 days after publication of the proposed rules in the Federal Register.

**IMPLICATIONS FOR REGISTERED INVESTMENT COMPANIES**

The revised rules will require the investment advisers to a significant number of registered investment companies to register with the CFTC as CPOs and will require compliance with certain disclosure, reporting and recordkeeping obligations that have historically not been relevant to such registered investment companies. In particular, registered investment companies should consider the following in order to comply with the CFTC’s new requirements:

- Any registered investment company that currently relies on the Section 4.5 exclusion from the definition of CPO should review its current and expected use of commodity interests (including swaps) to determine whether it may continue to avail itself of the Section 4.5 exclusion once the amendments are effective, and take steps to ensure that it complies with the other requirements of the amended rule including the marketing requirement and the annual notice filing requirement.

- Registered investment companies that will no longer qualify for the exclusion from the definition of CPO, and their investment advisers, should prepare for compliance with the new disclosure, reporting, filing, record keeping and (in the case of advisers) registration requirements discussed above, including the requirements regarding risk disclosure statements with respect to commodity interests including swaps, by the applicable compliance deadlines, and may wish to consider commenting on the Harmonization Proposal after considering its implications for their particular situations.

- Registered investment companies should update their compliance policies and procedures required by Rule 38a-1 under the Investment Company Act in light of the CFTC’s actions, and should seek assurances from their investment advisers, subadvisers, administrators, principal underwriters and potentially other service providers concerning the updating of their respective compliance policies and procedures and plans for ensuring timely compliance with the new requirements.

**COMPLIANCE TIMELINE**

The revised rules will become effective 60 days after they are published in the Federal Register. The timeline for compliance with the revised rules varies by rule and according to the size of the registered entity, and is conditioned on the adoption of certain regulations proposed by the CFTC, including the Harmonization Proposal.
CFTC Adopts Final Rule Amendments Regarding Registration and Reporting Requirements for CPOs and CTAs and Issues Regulatory Harmonization Proposal

February 22, 2012

**AMENDMENTS TO SECTION 4.5**

Entities required to register as CPOs as a result of the amendments to Section 4.5 must do so by the later of December 31, 2012 and the date that is 60 days after the effective date of the CFTC’s final rulemaking defining the term “swap” and establishing margin requirements for such instruments. In addition, entities required to register due to the amendments to Section 4.5 shall be subject to the CFTC’s disclosure, reporting and recordkeeping regime within 60 days of the effective date of final rules implementing the Harmonization Proposal.

**RESCISSION OF SECTION 4.13(a)(4)**

Any entity that previously relied on Section 4.13(a)(4) for an exemption from registration and that is not otherwise exempt from registration must comply with the new rules by December 31, 2012. All other CPOs, such as entities formed after the effective date of the revised rules, must comply with the rescission of Section 4.13(a)(4) by the date that is 60 days after publication of the revised rules in the Federal Register.

**AMENDMENTS TO SECTION 4.27**

The amendments to Section 4.27, which mandate new periodic reporting, will become effective on July 2, 2012. CPOs with at least $5 billion in assets under management at any time during the most recent reporting period must comply with Section 4.27 by September 15, 2012. All other registered CPOs must comply by December 14, 2012.

The compliance deadline for all other aspects of the new rules is December 31, 2012.

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CFTC Adopts Final Rule Amendments Regarding Registration and Reporting Requirements for CPOs and CTAs and Issues Regulatory Harmonization Proposal

February 22, 2012

ENDNOTES


4 7 U.S.C. 1a(10).

5 “Commodity interests” include listed futures contracts, commodity options and swaps. See Amendments to Commodity Pool Operator and Commodity Trading Advisor Regulations Resulting from the Dodd-Frank Act, 76 Fed. Reg. 11701 (March 3, 2011) (proposing the amendment of the term “commodity interests” to include swaps).

6 For purposes of the CEA as amended by Dodd Frank, a CTA is a person who (w) for compensation or profit, engages in the business of advising others, either directly or through publications, writings, or electronic media, as to the value of or the advisability of trading in (i) any contract of sale of a commodity for future delivery, security futures product, or swap; (ii) certain agreements, contracts, or transactions authorized under the CEA; (iii) any commodity option authorized under the CEA; or (iv) any leveraged transaction authorized under the CEA; (x) for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the activities referred to in clause (w); (y) is registered with the CFTC as a CTA; or (z) the CFTC, by rule or regulation, may include if the CFTC determines that the rule or regulation will effectuate the purposes of the CEA.


8 In the Adopting Release, the CFTC explained its concern that “registered investment companies are offering managed futures strategies, either in whole or in part, without Commission oversight and without making the disclosures to both the Commission and investors regarding the pertinent facts associated with the investment in the registered investment company.” Adopting Release, p. 14. The trading and marketing restrictions being added to Section 4.5 are restrictions that had previously been in the rule but were removed by amendments approved by the CFTC in 2003. Important distinctions between the prior version of the rule and the revised Section 4.5 are the inclusion of swaps in the definition of commodity interest and the addition of an alternative net notional value test. See 68 Fed. Reg. 47221 (Aug. 8, 2003).

9 The version of the Adopting Release distributed by the CFTC prior to publication of the revised rules in the Federal Register included a typographical error that we have been advised will be corrected before publication of the final rules in the Federal Register. The unpublished preamble refers consistently to the trading and net notional value tests as alternatives. However, the unpublished version of amended Section 4.5 mistakenly indicated that all the criteria in Section 4.5(c)(2)(iii)(A) through (C) needed to be satisfied for the exclusion to be available to a registered investment company. The CFTC has confirmed that the rule will be clarified before publication (Endnotes continued . . .)
ENDNOTES (CONTINUED)

and that the two threshold tests are in the alternative. In the final version of Section 4.5, the CFTC will insert the word “or” at the end of paragraph (c)(2)(iii)(A).

10 The CFTC’s definition of bona fide hedging transaction is restrictive and does not encompass “equitization of cash” or certain “risk management” transactions frequently undertaken by some registered investment companies. The CFTC rejected requests that “risk management” activities be included among transactions that would not trigger registration under Section 4.5, noting among other things that there is no generally accepted definition of the term “risk management.” See Adopting Release, pp. 17-19.

11 With respect to an option that is in-the-money at the time of purchase, the in-the-money amount may be excluded in computing such five percent.

Adopting Release, p. 22.

13 Section 4.5(c)(2)(iii)(B)(1)-(2).

14 In the Adopting Release, the CFTC also stated that the phrase “(or otherwise seeking investment exposure to)” did not meaningfully add to the marketing restriction.

Adopting Release, pp. 26-27. The CFTC indicated that it will give more weight to the final factor in the list when determining whether a registered investment company is operating as a de facto commodity pool.

16 Section 4.13(a)(3)(ii)(B).

17 Adopting Release, p. 46.

18 Adopting Release, p. 44. The CFTC recited its policy on reliance on interpretative letters by persons other than the addressee, which is generally permissive, in footnote 125 of the Adopting Release. The same footnote cites relevant CFTC interpretative letters. Although the Adopting Release does not indicate whether the CFTC staff has been directed to evaluate foreign advisor and fund of funds exemptions, it notes that the staff will consider requests for exemptive relief for funds of funds on a case by case basis and that foreign advisors may file notices of claims of exemption under Section 4.13(a)(3).

19 CPOs and CTAs engaged in retail off-exchange foreign exchange activities are required to apply to be a foreign exchange firm on Form 7-R and have at least one principal that is an approved foreign exchange-associated person.

20 The CFTC is also requiring an additional risk disclosure statement in disclosure documents from CPOs and CTAs that engage in swaps transactions. This disclosure would inform pool participants and advisory clients about certain potential risks, such as that swaps may have limited liquidity and be hard to value, pool participants may have difficulty redeeming their interests in the pool, and advisory clients may have difficulty liquidating their accounts.

21 Commodity pools with net assets equal to or less than $500,000 at the beginning of the pool’s fiscal year may distribute financial reports on a quarterly basis. See Section 4.22(b).

22 Form PF requests certain information regarding private funds and their operations. As defined in Form PF, a “private fund” is an issuer that would be an investment company (as defined in the Investment Company Act) but for an exclusion under Section 3(c)(1) or 3(c)(7) of the Investment Company Act. Respectively, Sections 3(c)(1) and 3(c)(7) generally provide exclusions for private funds with no more than 100 beneficial securityowners and private funds exclusively owned by “qualified purchasers.”

23 The CFTC has also moved proposed question 12, which asked for information regarding positions, from proposed Schedule A to Schedule B of Form CPO-PQR to avoid collecting duplicate information from dual registrants.

(Endnotes continued . . .)
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<th>ENDNOTES (CONTINUED)</th>
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<tr>
<td>24. The CFTC originally proposed a threshold of $1 billion for large CPOs but increased this amount to $1.5 billion in its final rules.</td>
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<td>25. Sections 4.24(b) and 4.34(b).</td>
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<td>28. Sommers’ suggestion seems particularly significant in light of the United States Court of Appeals for the District of Columbia striking down the SEC’s proposed proxy access rule, <em>Business Roundtable v. SEC</em>, 647 F.3d 1144 (D.C. Cir. 2011), and the same court’s decision in <em>Chamber of Commerce of the United States v. SEC</em>, 443 F.3d 890 (D.C. Cir. 2006).</td>
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<td>31. Required certifications include a certification that the units of participation in the pool will be sold pursuant to an effective registration statement under the Securities Act and that the units will be listed on a national securities exchange registered under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). The CFTC has proposed elimination of the listing requirement in Section 4.12(c) as most investment companies are not listed.</td>
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<td>32. In the Harmonization Proposal, the CFTC acknowledges that this approach may conflict with SEC requirements and regulations, and explains that it has had preliminary discussions with the SEC staff on this issue. The SEC staff has indicated to the CFTC that it may provide no-action relief if necessary and appropriate.</td>
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CFTC Adopts Final Rule Amendments Regarding Registration and Reporting Requirements for CPOs and CTAs and Issues Regulatory Harmonization Proposal

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