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Recent CFTC Amendments to CPO/CTA Registration and Reporting Requirements

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Original Title: Recent CFTC Amendments to CPO/CTA Registration and Reporting Requirements Will Significantly Affect Investment Advisers and Registered Investment Companies

Introduction

On February 9 the Commodity Futures Trading Commission adopted final rule amendments that rescind a commonly-used exemption from registration as a commodity pool operator ("CPO") and add new limitations to an exclusion from the definition of CPO upon which registered investment companies have commonly relied. [1] The CFTC also adopted additional reporting and disclosure requirements for CPOs and commodity trading advisers ("CTAs") and proposed new rule amendments that seek to harmonize certain of its requirements with those applicable to registered investment companies under SEC regulations. [2]

The CFTC approved the final rule amendments by a 4–1 margin, without holding a meeting to consider them. The objecting commissioner issued a strongly worded dissent, which argued that the CFTC's principal justification for its action — that it was an appropriate response to the recent financial crisis — had no apparent basis in fact and that, if challenged, the CFTC's cost-benefit analysis would not likely survive judicial review. The CFTC unanimously agreed to issue the proposing release for harmonizing its requirements with those of the SEC for registered investment companies that will be required to register as CPOs.

In this Alert, we highlight the key components of these final and proposed rule amendments and discuss certain practical consequences that they will have for investment advisers and registered investment companies. We also provide a brief timeline of when the final rule amendments will be implemented.

For ease of reference, below we include an index to the main sections of this Alert:

I. Rescission of the CPO Exemption under § 4.13(a)(4)

II. Retention and Amendment of the CPO Exemption under § 4.13(a)(3)

III. Additional Conditions to the CPO Exclusion under § 4.5 for Registered Investment Companies IV. Proposing Release: Harmonization of CFTC/SEC Requirements for Registered Investment Companies

V. New Reporting Requirements for Registered CPOs and CTAs VI. Guidance Regarding "Fund of Funds" Structures

VII. Deferred Consideration of Foreign Adviser Exemption VIII. Deferred Consideration of Family Office Exemption

IX. Other Final Rule Amendments

X. Implementation Timeline

I. Rescission of the CPO Exemption under § 4.13(a)(4)

Historically, § 4.13(a)(4) of the CFTC's regulations allowed a person to avoid registration as a CPO [3] under the Commodity Exchange Act (the "CEA") if, for each pool for which the person claimed exemption from registration:

- Interests in the pool were exempt from registration under the Securities Act of 1933 (the "1933 Act") and were offered and sold without marketing to the public in the United States; and
- The person reasonably believed, at the time of investment (or, in the case of an existing pool, at the time of conversion to a pool meeting the criteria of § 4.13(a)(4)), that
  - Each natural person participant was a "qualified eligible person" of the type specified in the CFTC's regulations; [4] and
  - Each non-natural person participant was a qualified eligible person or an "accredited investor" within the meaning of Regulation D under the 1933 Act. [5]

Investment advisers and sponsors have relied extensively on the § 4.13(a)(4) exemption as a means of avoiding registration with respect to private funds that invest or trade in instruments that are subject to the CFTC's jurisdiction under the CEA, including commodity futures and options, security futures products, and – following adoption of the Dodd-Frank Act – swaps. In particular, advisers and sponsors to private funds relying on Section 3(c)(7) of the Investment Company Act of 1940 (the "1940 Act") have often looked to this exemption.

Acting on its February 2011 proposal, [6] the CFTC rescinded the § 4.13(a)(4) exemption. According to the final rule release, the CFTC determined that this action was necessary to ensure that CPOs will be subject to "similar regulatory obligations" as investment advisers to private funds that are excluded from the definition of "investment company" by virtue of Sections 3(c)(1) and 3(c)(7) of the 1940 Act. Accordingly, the CFTC concluded it was "appropriate to limit regulatory arbitrage" between the SEC and CFTC regimes "with respect to pools that are similarly situated to private funds" and to harmonize "the scope of its data collection" with the SEC's new reporting requirements on Form PF. [7] The CFTC also explained that it had rescinded the exemption "to ensure adequate customer protection and market oversight," because the § 4.13(a)(4) exemption contained "no limit[] on the amount of commodity interest trading in which pools operating [thereunder] can engage." [8]

Absent another available exemption or an exclusion from the CPO definition, therefore, investment advisers to private funds that are considered commodity pools will become subject to the panoply of CFTC registration, compliance and reporting requirements — including the new reporting requirements that we discuss below.

II. Retention and Amendment of the CPO Exemption under § 4.13(a)(3)

Section 4.13(a)(3) of the CFTC's regulations allows a person to avoid registration as a CPO if each pool for which the person claims the exemption only offers interests pursuant to an exemption from registration under the 1933 Act and without marketing to the U.S. public. In addition, each pool must limit its commodity interest positions — including positions held for bona fide hedging purposes [9] — such that either (a) the aggregate initial margin, premiums and required minimum security deposit required to establish those positions will not exceed five percent of the liquidation value of the pool's portfolio, [10] or (b) the aggregate net notional value of those positions, determined at the time that the most recent position was established, does not exceed 100 percent of the liquidation value of the pool's portfolio. Under each test, the pool's unrealized profits and unrealized losses must be taken into account. Investment advisers and other private fund sponsors have relied on § 4.13(a)(3) to avoid registration as a CPO with respect to private funds that engage in only a de minimis amount of commodity investing. This exemption has been commonly used by advisers and sponsors of private funds relying on Section 3(c)(1) of the 1940 Act.

The CFTC had proposed to rescind this exemption in February 2011, but — in a welcome development for market participants — ultimately declined to do so. The CFTC appears to have been persuaded that the amount of derivatives-related activity in which pools engage in reliance on § 4.13(a)(3) is insignificant and therefore does not merit CFTC oversight of the CPOs to those pools. [11]

The CFTC has amended § 4.13(a)(3) to address how to calculate the notional value of swaps and how to net swaps, given that Dodd-Frank amended the CEA to add references to those instruments. In addition, the CFTC will now require a CPO relying on § 4.13(a)(3) to submit an annual notice to the National Futures Association (the "NFA") affirming its ability to continue relying on the exemption. If a CPO cannot affirm its ability to do so, the CPO will be required to withdraw the exemption and, if necessary, apply for registration as such. [12]

III. Additional Conditions to the CPO Exclusion under § 4.5 for Registered Investment Companies

The CFTC has amended § 4.5 of its regulations, which provides an exclusion for investment companies from the CPO definition. Broadly speaking, the CFTC's amendments impose a marketing restriction and a trading threshold (or alternative net notional value test) on registered investment companies that seek to rely on the § 4.5 exclusion. The CFTC proposed these amendments in February 2011, after having received a petition from the NFA indicating that — in the CFTC's words — "certain registered investment companies were offering interests in de facto commodity pools while claiming exclusion under § 4.5." [13] Since "it believed that registered investment companies should not engage in such activities without [CFTC] oversight," the CFTC proposed and adopted amendments that are intended to restrict both the amount of their investments in commodity instruments (including swaps) and the extent to which they purport to market themselves as vehicles for commodities trading.

Trading Threshold; Alternative Net Notional Value Test — Amended § 4.5 provides that a registered investment company seeking to rely on the exclusion must represent, in a notice of eligibility filed with the NFA, that it uses commodity futures, commodity option contracts and swaps solely for bona fide hedging purposes. However, an investment company may also rely on the exclusion if, with respect to its non-hedging investments in commodity interest positions, it can represent to the NFA that either:

- With respect to positions in commodity futures, commodity option contracts or swaps, the aggregate initial margin and premiums required to establish those positions will not exceed five percent of the liquidation value of its portfolio, after taking into account unrealized profits and unrealized losses; [14] or
- The aggregate net notional value of commodity futures, commodity option contracts or swaps positions, determined at the time that the most recent position was established, does not exceed 100 percent of the liquidation value of its portfolio, after taking into account unrealized profits and unrealized losses. [15]

The CFTC considered and rejected suggestions to expand bona fide hedging for purposes of § 4.5 to include risk management activities. According to the CFTC, risk management can be distinguished from bona fide hedging activities because the latter "are unlikely to present the same level of market risk as they are offset by exposure in the physical markets." Moreover, the CFTC considered that, in absence of a clear definition for risk management activities, the § 4.5 exclusion would become "onerous to enforce." [16]

Marketing Restriction — Amended § 4.5 requires that a registered investment company must represent, in a notice of eligibility filed with the NFA, that it will not be, and has not 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. In a helpful change from its proposal, the CFTC struck language that would have required a registered investment company to represent that it was not "otherwise seeking exposure to" commodities and swaps. The CFTC agreed with commenters that this additional language introduced unwelcome ambiguity into the restriction. Arguably, that language could have been read to include basic disclosure regarding an investment company's strategies and related risks.

In an effort to respond to industry comments, the CFTC has enumerated factors that "it would consider in making the determination whether an entity [had] violated the marketing restriction," which are as follows:

- 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 using derivatives in a portfolio or make comparisons to a derivatives index;
- Whether, during the course of its normal trading activities, the fund or an entity 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 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. [17]

The CFTC has stressed that these factors are merely "instructive," and "that no single factor is dispositive." At the same time, however, the CFTC indicated that it "will give more weight to the final factor" listed above in considering "whether a registered investment company is

a de facto commodity pool." In addition, the CFTC explained that the fact a fund includes "futures" or "derivatives" in its name "will not be considered a dispositive factor, but rather one of many" it will consider in determining whether the fund has violated the marketing restriction. The CFTC also indicated that it "will not consider the mere disclosure to investors or potential investors that the registered investment company may engage in derivatives trading incidental to its main investment strategy and the risks associated therewith as being violative of the marketing restriction." [18]

In discussing these factors, the CFTC observed that some registered investment companies use CFCs to invest up to 25 percent of their assets in derivatives. The CFTC indicated that using a CFC in this way may indicate an investment company is engaging in derivatives trading that exceeds the trading threshold discussed earlier. The CFTC also suggested it would consider an investment company's use of a CFC when evaluating whether the investment company had violated the marketing restriction.

Status of Controlled Foreign Corporations — The CFTC stated that a CFC would fall within the definition of "commodity pool" in the CEA and related CFTC regulations. [19] Even though a CFC would be wholly owned by a registered investment company, the CFTC noted that each of the investment company and the CFC "must be assessed on its own characteristics. . . ." As a result, the CFTC concluded, a CFC "should not be entitled" to the § 4.5 exclusion simply because its parent investment company may rely on it. Thus, while the CFTC "does not oppose the use of CFCs" in principle, it explained that these entities "will be required to have their own CPOs register with the [CFTC] unless they may claim exemption or exclusion . . . on their own merits." [20]

Plainly, the CFTC's commentary on this subject will inform how and whether investment companies continue to use CFCs to invest in commodity instruments. Investment companies have chosen to rely on CFCs for a variety of reasons, including for administrative convenience and in order to help satisfy the composition of income test under Section 851(b)(2) of the Internal Revenue Code of 1986. It should be noted, however, that the tax treatment of income from commodities investments held through CFCs has been questioned in a recent Congressional hearing and in statements by IRS officials.

Identification of Entity Subject to Registration Requirement — The CFTC has concluded that the investment adviser to a registered investment company no longer able to rely on the § 4.5 exclusion would be the entity required to register as a CPO. The CFTC added that the registration requirement would not apply to the investment company's board of directors, or to any individual board member solely as a result of his or her board membership, "as it would result in piercing the limitation on liability for actions undertaken in the capacity of director." [21] The CFTC's position on this matter should go a long way in resolving concerns that investment company directors have expressed regarding compliance with the regulatory regime for CPOs.

Annual Notice — A registered investment company relying on the § 4.5 exclusion will be required to submit an annual notice to the NFA affirming its ability to continue doing so. In practice, this notification requirement will require the investment company to confirm that it continues to satisfy the trading threshold (or alternative net notional value test) and marketing restriction. If an investment company cannot make this representation, it will be required to withdraw the exclusion and, if necessary, cause its investment adviser to register as a CPO on its behalf.

IV. Proposing Release: Harmonization of CFTC/SEC Requirements for Registered Investment Companies

In a companion release to its final rules, the CFTC proposed rule amendments that purport to harmonize certain requirements for CPOs with those applicable to registered investment companies under SEC regulations. The CFTC's proposal is based on relief that it granted in 2011 under § 4.12(c) to exchange traded funds, which are themselves a type of registered investment company. [22]

Delivery and Acknowledgment of Disclosure Documents — Section 4.21 of the CFTC's regulations provides that a CPO may not accept or receive funds, securities or other property from a prospective pool participant unless the CPO first receives a signed and dated acknowledgment stating that the prospective participant received a disclosure document for the pool. The CFTC is proposing to provide relief to registered investment companies from these delivery and acknowledgment requirements. As conditions to this relief, a registered investment company would be required to make a current disclosure document readily available online, notify prospective investors that the disclosure document is available online, and direct any broker- dealer or selling agent to inform prospective participants of the online availability of the disclosure document.

Section 4.26(b) of the CFTC's regulations requires the disclosure document for a commodity pool to include a copy of the pool's most recent account statement and annual report. The CFTC is proposing to relieve registered investment companies from complying with this requirement if they make their account statements and annual reports available online.

Other Pool Performance — The CFTC is proposing to provide relief to registered investment companies from the requirement for a pool that has operated for less than three years to disclose the performance of other pools and accounts in their disclosure documents. [23] The CFTC's proposal would require that the performance information be provided in the investment company's statement of additional information. The CFTC has acknowledged that these requirements may conflict with applicable SEC requirements on the presentation of performance information, and that the SEC staff has indicated it would consider requests for no-action relief regarding the CFTC- mandated disclosures.

Break-Even Point Disclosure — The CFTC is proposing that the "break-even point" [24] disclosure required under § 4.24(d)(5) of its regulations be presented following the last required item in the summary prospectus for an open-end investment company (i.e., a mutual fund) and, for a closed- end investment company, in the forepart of the prospectus.

Disclosure of Fees and Expenses — The CFTC's proposal would require a registered investment company to disclose in its prospectus any fees and expenses listed in § 4.24(i) that are not otherwise required to be disclosed in the fee table pursuant to applicable SEC requirements. [25] The proposal would also require an investment company to include a tabular presentation of the calculation of its break-even point as specified in § 4.24(i)(6) of its regulations.

Mandatory Disclaimer — The CFTC is proposing that a registered investment company subject to CPO regulation include on the cover of its prospectus a cautionary statement that combines the language required by Rule 481(b)(1) under the 1933 Act and § 4.24(a) of the CFTC's regulations.

Delivery and Certification of Account Statements — Section 4.22(a) of the CFTC's regulations requires a CPO to deliver monthly account statements to pool participants. (An account statement is required to take the form of a statement of income (loss) and a statement of changes in net asset value for the prescribed period.) The CFTC is proposing to allow registered investment companies to satisfy this delivery requirement by making those statements available online, provided they disclose that the account statements are readily accessible online and identify the website where they are located. The CFTC is also proposing to allow registered investment companies to use the certification for periodic reports required by the SEC's Form N-CSR in lieu of the certification required under § 4.22(h) of its regulations with respect to these account statements.

Timing of Disclosure Updates — Currently, § 4.26 of the CFTC's regulations provides that a disclosure document may be used for nine months from the date of the document before an updated version must be prepared and filed. The CFTC is proposing to allow registered investment companies to make this update after 12 months, which is in keeping with the annual update process mandated by SEC regulations for their registration statements.

Recordkeeping — The CFTC is proposing to grant registered investment companies relief from § 4.23, which requires a CPO to keep specified books and records at its main business office. The proposed relief would allow an investment company to keep those records elsewhere.

V. New Reporting Requirements for Registered CPOs and CTAs

The CFTC has adopted new § 4.27, which requires CPOs and CTAs [26] registered or required to be registered as such to report information on Form CPO-PQR and Form CTA-PR, respectively. These new Forms are intended to mirror the reporting that registered investment advisers must make on Form PF with respect to their private fund clients. CPOs and CTAs must file these new Forms with the NFA.

Form CPO-PQR

Form CPO-PQR is divided into three parts:

- Schedule A, which requests basic information about a CPO, its assets under management, the pools managed by the CPO, certain service providers to those pools, monthly rates of return, and subscription and redemption activity. A registered CPO is required to file Schedule A with the NFA, even if it is a registered investment adviser that must separately file Form PF with the SEC. Each registered CPO must file Schedule A, regardless of the amount of its assets under management.
- Schedule B, which requests detailed information about commodity pools managed by "mid- sized CPOs" [27] and "large CPOs." [28] Generally speaking, Schedule B requires those CPOs to report information about pool strategies, borrowings and types of creditors, counterparty credit exposure, pool trading and clearance mechanisms, aggregate derivatives positions, and pool investments.
- Schedule C, which requests additional detailed pool information from large CPOs. Schedule C requires those CPOs to provide a geographic breakdown of pool investments and the turnover rate of aggregate pool portfolios. In addition, with respect to "large pools," [29] large CPOs must report counterparty credit exposure, risk metrics, borrowing information, derivative positions and posted collateral, financing liquidity, and participant information.

Information requests in Schedules B and C pertain to the reported pools' commodity interest positions and other investments.

Smaller CPOs must file Schedule A annually, mid-sized CPOs must file Schedules A and B annually, and large CPOs must file Schedules A, B and C quarterly. Smaller CPOs must file Schedule A, and mid-sized CPOs must file Schedules A and B, within 90 days of the end of each calendar year. [30] Large CPOs must file Schedules A, B and C within 60 days of the end of each calendar quarter.

The CFTC has sought to avoid mandating duplicate reporting by CPOs that are also registered as investment advisers with the SEC. Accordingly, the CFTC has explained that, under § 4.27(d), a dual-registered CPO will be permitted to satisfy the requirement to report information on Schedules B and C of Form CPO-PQR by filing Form PF with the SEC.

In addition, § 4.27(d) addresses the filing obligations of registered investment companies that are registered or required to be registered as CPOs. As noted above, the CFTC has clarified that the investment adviser to a registered investment company that can no longer rely on the § 4.5 exclusion will be the entity required to register as a CPO. Section 4.27(d) provides that if the investment adviser is required to file Form PF with the SEC, the investment adviser may also report the activities of the investment company on that Form. (An adviser to one or more registered investment companies no longer able to rely on the § 4.5 exclusion and that has no private fund clients will not be able to file on Form PF.) Nonetheless, the CFTC indicated in the final rule release that a dual-registered CPO satisfying its reporting obligations by filing Form PF must separately file Schedule A of Form CPO-PQR with the NFA. [31] Section 4.27(d) also provides that each Form PF filed with the SEC by a CPO shall be deemed to have been filed with the CFTC for purposes of any enforcement action.

Form CTA-PR

Form CTA-PR requires a CTA to report basic identifying information, the total assets and total pool assets directed by the CTA, the names of the pools the CTA advises, and the name of the CPO reporting information for each identified pool. CTAs are required to complete Form CTA-PR annually and to submit the Form to the NFA, even if the CTA is also registered with the SEC and reporting on Form PF. A CTA must file its Form CTA-PR within 45 days of the end of each calendar year. In addition, § 4.27(d) provides that any Form PF a CTA files with the SEC will be deemed to have been filed with the CFTC for enforcement purposes.

Reporting by Affiliated Entities

The final rule release provides that affiliated entities are permitted to report on a single Form CPO- PQR or Form CTA-PR with respect to all affiliates and pools that they operate or advise. Where a pool is operated by multiple CPOs, the CFTC has indicated that only one CPO should report on the pool's activities. The reporting CPO must identify the other CPOs involved in operating the pool, however.

VI. Guidance Regarding "Fund of Funds" Structures

In two instances, the CFTC noted that it had received comments seeking exemptive relief for funds that do not invest directly in commodities (i.e., investing funds in "fund of funds" structures, where only the investee funds make commodities investments).

In the first case, the CFTC noted that certain commenters had sought a separate exemption from CPO registration for the investing fund because of its proposal to rescind the § 4.13(a)(4) exemption. The CFTC declined to do so, but offered that it would be in a better position to consider the matter once it began receiving information about "fund of funds" structures as reported on Forms CPO-PQR and CTA-PR. The CFTC also suggested that it would consider exemptive requests from investing funds in "fund of funds" structures on a case-by-case basis. [32]

In the second instance, the CFTC noted that a commenter had requested relief from the requirement to report on Form CPO-PQR for funds that invest in unaffiliated commodity pools. The commenter had argued that these investing funds should not be considered in the business of trading commodity interests and, therefore, should not be subject to the reporting obligation. The CFTC declined to provide the requested relief, instead amending Form CPO-PQR to limit the type of information that an investing fund would be required to report with respect to investee funds (i.e., the names of the investee funds and the size of its investments in those funds).

The CFTC went further, asserting that the definition of "commodity pool" makes "no distinctions between direct and indirect investments in commodity interests. . . ." As a result, the CFTC observed, allowing investing funds to avoid reporting obligations "would create an incentive for entities to avoid direct investment in commodity interests and possibly increase the opacity of the market." Worse, the CFTC concluded that "a fund that invests in an unaffiliated commodity pool is a commodity pool for purposes of the CEA and the [CFTC's] regulations promulgated thereunder." [33]

It bears noting that, notwithstanding this commentary, the CFTC's guidance regarding the application of § 4.13(a)(3) to "fund of funds" structures remains in place. [34]

VII. Deferred Consideration of Foreign Adviser Exemption

The CFTC noted that it had been asked to consider adopting a "foreign adviser exemption" for CPOs in light of its proposal to rescind the exemptions provided by §§ 4.13(a)(3) and 4.13(a)(4). Commenters had proposed an exemption modeled after the "foreign private adviser" exemption that the Dodd-Frank Act added to the Investment Advisers Act of 1940 (the "Advisers Act"). [35] The CFTC decided to defer considering whether to grant such an exemption, citing a lack of information regarding the positions and trading of CPOs that are currently exempt from registration. The CFTC suggested that it may reconsider the concept of a foreign adviser exemption once it has had an opportunity to review the information reported on Forms CPO-PQR and CTA-PR. [36]

VIII. Deferred Consideration of Family Office Exemption

The CFTC also received several comments requesting that it adopt an exemption from CPO registration for family offices modeled after the family office exception that the Dodd-Frank Act added to the Advisers Act, as further delineated in a new SEC rule. [37] As with the

request for a foreign adviser exemption, the CFTC determined to withhold consideration of a family office exemption until it has developed a more complete understanding of the commodities activities of those firms. The CFTC also noted that family offices remain free to seek individual relief from the registration requirement and may continue to rely on existing CFTC staff interpretations addressing their status under its regulations. [38] The CFTC also declined to provide family offices with relief from the new reporting requirements under § 4.27 of its regulations, citing the need to collect data from those firms to ascertain whether a family office exemption would be appropriate.

Commissioner Sommers criticized the CFTC's release on this last count, noting in her dissent that the CFTC was seeking to "'split the baby'" by allowing family offices to rely on prior staff interpretations for relief while also stressing the importance of requiring those firms to report information under § 4.27. [39]Despite this observation, it would appear the CFTC takes the position that, depending upon their individual circumstances, family offices may continue to rely on existing interpretations.

IX. Other Final Rule Amendments

Confidential Treatment of Reported Information — The CFTC has amended its regulations to provide that the information reported in Schedules B and C of Form CPO-PQR shall be deemed nonpublic, as well as information reported in Schedule A regarding distribution and marketing channels, changes concerning assets under management, rates of return, subscription and redemption activity, and other related information. In addition, the CFTC has determined that it will treat as confidential information reported on Form CTA-PR regarding the names of advised pools and the CPOs responsible for reporting information about them. [40]

Risk Disclosure Statements — The CFTC adopted its proposal to require CPOs and CTAs to include new standard risk disclosures in their disclosure documents regarding the use of swaps. [41] The CFTC indicated that these new disclosures were appropriate in light of the Dodd-Frank Act having amended the definitions of CPO, CTA and commodity pool in the CEA to include references to swaps.

Technical Amendments to § 4.7 — The CFTC also adopted two amendments to § 4.7, which provides an exemption from certain requirements otherwise applicable to CPOs with respect to offerings to qualified eligible persons and for CTAs with respect to advising qualified eligible persons. The first amendment adds a cross-reference to the "accredited investor" definition included in Regulation D under the 1933 Act, which — unlike including elements of the definition itself — will enable the regulation to remain current with any future changes that the SEC adopts. The second amendment eliminates relief for CPOs relying on § 4.7 from the requirement to certify financial statements included in a commodity pool's annual report. In this last regard, the CFTC noted it had found that 91 percent of pools operating under § 4.7 filed certified financial statements for the 2010 fiscal year; it therefore concluded that this relief was no longer necessary.

X. Implementation Timeline

The CFTC's final rule amendments will become effective 60 days after the final rule release is published in the Federal Register. However, the requirements under § 4.27 for CPOs and CTAs to report on Forms CPO PQR and CTA-PR, respectively, will become effective on July 2, 2012.

Notwithstanding these effective dates, CPOs and CTAs will be required to comply with the rule amendments according to the following implementation timeline:

- Registered investment companies that are no longer able to rely on the § 4.5 exclusion will be required to register as CPOs by the later of the following two dates: December 31, 2012, or 60 days after the effective date of rules further defining the term "swap" pursuant to the Dodd- Frank Act. [42] Entities that must register as CPOs because of the amendments to § 4.5 will not be required to comply with the applicable recordkeeping, reporting and disclosure requirements until 60 days after the CFTC's proposed "harmonization" amendments have been adopted and become effective.
- CPOs that had relied on the § 4.13(a)(4) exemption will be required to comply with the rescission of that provision (i.e., they must register or find an exclusion or another exemption) by December 31, 2012. All other CPOs will be required to comply with the rescission (i.e., not seek to rely on it) within 60 days after the final rule release is published in the Federal Register.
- The CFTC has adopted the following phase-in period for the new reporting requirements under § 4.27:
    - **CPOs with $5 billion or more in assets under management** — CPOs with at least $5 billion in assets under management as of June 30, 2012,must comply with the reporting requirements by September 15, 2012. In practice, this means each of these CPOs must file its first Form CPO-PQR within 60 days after September 30, 2012.
    - **Everyone Else** — All other CPOs and all CTAs must comply with their reporting requirements by December 15, 2012. In practical terms, each of these CPOs and CTAs must file its first Form CPO-PQR or Form CTA-PR, as applicable, based on information as of December 31, 2012. As noted above, smaller and mid-sized CPOs must file Form CPO-PQR within 90 days of the end of each calendar year, and CTAs must file Form CTA-PR within 45 days of the end of each calendar year. Large CPOs falling below the $5 billion threshold must file Form CPO- PQR within 60 days after December 31, 2012; the information reported would be on a quarterly basis.
- CPOs and CTAs must comply with the rule amendments not specified above by December 31, 2012.

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[1] Commodity Pool Operators and Commodity Trading Advisers: Amendments to Compliance Obligations (Feb. 9, 2012) (hereinafter "Notice of Final Rules").

[2] Harmonization of Compliance Obligations for Registered Investment Companies Required to Register as Commodity Pool Operators (Feb. 9, 2012) (hereinafter "Notice of Proposed Rules").

[3] The CEA defines the term "commodity pool operator" to include any person "engaged in a business that is of the nature of a commodity pool, investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in commodity interests," including any commodity for future delivery, security futures product, or swap; authorized commodity option or leverage transaction; and certain other

agreements, contracts, and transactions described elsewhere in the CEA. The term also includes any person who is registered with the CFTC as such. *See* 7 U.S.C. § 1a(11).

[4] *See* 17 C.F.R. § 4.7(a)(2).

[5] *See* 17 C.F.R. § 230.501(a)(1)-(3), (a)(7), (a)(8).

[6] *See* Commodity Pool Operators and Commodity Trading Advisers: Amendments to Compliance Obligations, 76 Fed. Reg. 7976 (Feb. 11, 2011) (Proposed Rules).

[7] *See* Notice of Final Rules, at 46.

[8] *See* Notice of Final Rules, at 49.

[9] The concept of "bona fide hedging" is described in detail elsewhere in the CFTC's regulations. *See* 17 C.F.R. §§ 1.3(z)(1) & 151.5.

[10] Section 4.13(a)(3) provides that in the case of an option that is in-the-money at the time of purchase, the in-the-money amount may be excluded in computing this percentage. *See* 17 C.F.R. §190.01(x) (defining "in-the-money amount").

[11] *See* Notice of Final Rules, at 41.

[12] Substantially the same requirement would apply with respect to a person claiming an exclusion from the CPO definition under § 4.5 or an exemption from registration as a CTA under § 4.14.

[13] *See* Notice of Final Rules, at 10; *See also* Notice of Petition, 75 Fed. Reg. 56997 (Sept. 17, 2010).

[14] Section 4.5 provides that in the case of an option that is in-the-money at the time of purchase, the in-the-money amount may be excluded in computing this percentage. *See* 17 C.F.R. §190.01(x) (defining "in-the-money amount").

[15] It is plain from the preamble in the final rule release that the CFTC intends for these tests to apply in the alternative – a registered investment company may satisfy either one in *See*king to rely on § 4.5. However, this concept is not entirely clear on the face of the rule text that was released on February 9.

[16] *See* Notice of Final Rules, at 18.

[17] *See* Notice of Final Rules, at 26-27.

[18] *See* Notice of Final Rules, at 27.

[19] *See* 7 U.S.C. § 1a(10); 17 C.F.R. § 4.10(d)(1).

[20] *See* Notice of Final Rules, at 31.

[21] *See* Notice of Final Rules, at 29.

[22] *See* Commodity Pool Operators: Relief from Compliance with Certain Disclosure, Reporting and Recordkeeping Requirements for Registered CPOs of Commodity Pools Listed for Trading on a National Securities Exchange; CPO Registration Exemption for Certain Independent Directors or Trustees of These Commodity Pools, 76 Fed. Reg. 28641 (May 18, 2011).

[23] *See* 17 C.F.R. § 4.25(c)(2)-(5).

[24] *See* 17 C.F.R. § 4.10(j) (defining the term "break-even point" as "the trading profit that a pool must realize in the first year of a participant's investment to equal all fees and expenses such that such participant will recoup its initial investment, as calculated pursuant to rules promulgated by a registered futures association pursuant to section 17(j) of the [CEA].").

[25] *See* Form N-1A, Item 3 (open-end investment companies); Form N-2, Item 3 (closed-end investment companies).

[26] The CEA defines the term "commodity trading adviser" to include any person who, 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: any contract of sale of a commodity for future delivery, security futures product or swap; authorized commodity option or leverage transaction; and certain other agreements, contracts and transactions described elsewhere in the CEA. The term also includes any person who, for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any trading in such instruments, and any person who is registered with the CFTC as such. *See* 7 U.S.C. § 1a(12).

[27] According to the instructions for Form CPO-PQR, a "mid-sized CPO" is any CPO that had at least $150 million in aggregated pool assets under management as of the close of business on any day during the "reporting period." For a mid-sized CPO, the "reporting period" is the calendar year end.

[28] The instructions for Form CPO-PQR provide that a "large CPO" is any CPO that had a least $1.5 billion in aggregated pool assets under management as of the close of business on any day during the reporting period. (The CFTC had proposed a lower threshold of $1 billion.) For a large CPO, the "reporting period" is any individual calendar quarter ending March 31, June 30, September 30 or December 31.

[29] The Form CPO-PQR instructions define "large pool" as any pool with a net asset value (individually or in combination with any "parallel pool structure") of at least $500 million as of the close of business on any day during the reporting period. A "parallel pool structure" is any structure in which one or more pools pursues substantially the same investment objective and strategy and invests side-by-side in substantially the same assets as another pool.

[30] This 90-day reporting deadline is shorter than the 120-day deadline that the SEC provides for large private equity fund advisers and so-called "smaller" private fund advisers (e.g., advisers with less than $1.5 billion in hedge fund assets under management) to report on Form PF. *See* Form PF, Instruction 9.

[31] *See* Notice of Final Rules, at 55.

[32] *See* Notice of Final Rules, at 46.

[33] *See* Notice of Final Rules, at 62.

[34] *See* 17 C.F.R. pt. 4 App. A.

[35] Following amendment by the Dodd-Frank Act, the Advisers Act includes an exemption from registration with the SEC for an investment adviser that is a "foreign private adviser" – i.e., an investment adviser that: (a) has no place of business in the United States; (b) has, in total, fewer than 15 clients and investors in the United States in private funds advised by the investment adviser; (c) has aggregate assets under management attributable to clients in the United States and investors in the United States in private funds advised by the investment adviser of less than $25 million; (d) does not hold itself out generally to the public in the United States as an investment adviser; and (e) does not act as an investment adviser to an investment company registered under the 1940 Act or to a company that has elected to be treated as a business development company under the 1940 Act. *See* 15 U.S.C. § 80b-2 (a)(30), *See also* 15 U.S.C. § 80b-3(b)(3).

[36] *See* Notice of Final Rules, at 44-45.

[37] *See* 15 U.S.C. § 80b-2(a)(11)(G); 17 C.F.R § 275.202(a)(11)(G)-1. Paragraph (b) of the rule defines "family office" as a company (including its directors, partners, members, managers, trustees and employees acting within the scope of their position or employment) that: "(1) Has no clients other than family clients; provided that if a person that is not a family client becomes a client of the family office as a result of the death of a family member or key employee or other involuntary transfer from a family member or key employee, that person shall be deemed to be a family client for purposes of this [rule] for one year following the completion of the transfer of legal title to the assets resulting from the involuntary event; (2) is wholly owned by family clients and is exclusively controlled (directly or indirectly) by one or more family members and/or family entities; and (3) does not hold itself out to the public as an investment adviser."

[38] The CFTC provided citations to a number of these letters in the final rule release. *See* CFTC Letter No. 10-25 (June 25, 2010); CFTC Letter 00-100 (Nov. 1, 2000); CFTC Letter No. 96-24 (Mar. 4, 1996); CFTC Letter No. 97-29 (Mar. 21, 1997); CFTC Letter No. 95-35 (Nov. 23, 1994).

[39] *See* Notice of Final Rules, at 140.

[40] *See* 17 C.F.R. §§ 145.5(d)(1)(viii) & (h), 147.3(b)(4)(i)(H) & (b)(8).

[41] *See* 17 C.F.R. §§ 4.24(b)(5) (CPOs), 4.34(b)(4) (CTAs).

[42] In May 2011, the CFTC and the SEC issued a joint release proposing to further define the term "swap." See Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement. Recordkeeping, 76 Fed. Reg. 29818 (May 23, 2011); *See also* 76 Fed. Reg. 32880 (June 7, 2011) (making certain technical corrections).

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Josh Sterling’s practice focuses on representing investment companies and their independent directors. He helps clients evaluate how the federal securities laws may affect their investment management activities and, as needed, he assists them in obtaining exemptive relief and other guidance from the SEC and its staff. Mr. Sterling also advises non-U.S. asset managers on the legal and regulatory implications of offering their products and services in the United States.

Recently, Mr. Sterling represented a bank-sponsored mutual fund complex and its independent directors in multiple reorganization and liquidation transactions, following the banks’ strategic decision to discontinue its captive mutual fund business. Mr. Sterling also helped counsel a committee of independent directors during its review of several fund reorganizations that were prompted by a management buyout. In addition, he has assisted a multiple series trust and its independent board members evaluate proposals for launching new funds run by advisers who offer specialized investment approaches, including options-enhanced, multi-asset and international strategies. Josh regularly advises fund managers on compliance and operational matters.

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