

CLIENT ALERT

CFTC Issues Final Rules Regarding Exemptions, Registration and Compliance Obligations for CPOs and CTAs of Public and Private Funds

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On February 9, 2012, the Commodity Futures Trading Commission (CFTC) adopted final rules under the Commodity Exchange Act that will eliminate or modify certain registration exclusions and exemptions relied upon by both investment companies registered under the Investment Company Act of 1940 (mutual funds) as well as private funds. These rule changes may trigger registration and reporting requirements and it is important for all funds that trade in commodity futures, commodity options and derivatives, even on a limited basis, to evaluate their registration requirements.

CFTC section 4.5 currently excludes the sponsors of mutual funds from the definition of a commodity pool operator (CPO). The amendment to section 4.5 drastically restricts the exclusion and limits it to sponsors of mutual funds trading commodity interests at certain *de minimus* levels and that comply with certain marketing restrictions. Generally, to rely on the exclusion, a mutual fund must represent with respect to positions in commodity futures, commodity option contracts, and swaps used for purposes other than solely *bona fide* hedging purposes, that either:

- The aggregate initial margin and premiums required to establish such positions will not exceed 5% of the liquidation value of the qualifying entity's portfolio; or
- The aggregate net notional value of instruments determined at the time the most recent position was established does not exceed 100% of the liquidation value of the pool's portfolio.

These thresholds must be calculated after taking into account unrealized profits and losses on the instruments. The fund must also represent that it will not be, and has not been, marketed to the public as a commodity pool or as a vehicle for trading in the commodity futures, commodity options or swaps markets. A sponsor of a mutual fund that does not meet the new conditions will be required to register as a CPO and submit to CFTC and NFA (National Futures Association) regulation.

Amendments to section 4.5 become effective on July 2, 2012, but compliance is not required until the later of: (1) December 31, 2012, or (2) 60 days after the CFTC adopts a final rule defining the term "swap" and setting margin requirements for swap positions (both of which, as of the date of this alert, are still pending). Sponsors required to register as CPOs under section 4.5 will become subject to the Part 4 reporting, disclosure and recordkeeping requirements within 60 days following the effectiveness of a final rule by the CFTC to harmonize these requirements with those of the SEC (also pending).

Of significant importance to private funds, the CFTC repealed section 4.13(a)(4), which provided an exemption from registration for CPOs and commodity trading advisers (CTAs) that offer interests only to qualified eligible persons (QEPs) or accredited investors. Repeal of this section will be effective April 24, 2012. Private funds currently relying on section 4.13(a)(4) have until December 31, 2012 to register with the CFTC and then are subject to the disclosure, reporting and other compliance requirements of the CFTC.

The CFTC also modified, but did not rescind, the criteria for exemption under section 4.13(a)(3) for CPOs of private funds with minimal exposure to commodity interests. The CFTC revised this exemption to take into account swap transactions. To qualify for the exemption under amended section 4.13(a)(3), a CPO must restrict its futures and swap trading to the *de minimus* levels contained in section 4.5 and offer interests only to accredited investors, knowledgeable employees and certain QEPs. Unlike section 4.5, section 4.13(a)(3) does not permit unlimited commodity interest trading for *bona fide* hedging purposes.

The new amendments also require public and private funds that claim exclusionary or exemptive relief under sections 4.5, 4.13 and 4.14 from CPO or CTA registration to reconfirm their qualifications annually on a calendar year basis, commencing with the calendar year ending December 31, 2012.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

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