

## Amendments to CFTC Rule 4.5 Affecting Advisers to Registered Investment Companies Upheld

June 27, 2013

On Tuesday, June 25, 2013, a three-judge panel of the United States Court of Appeals for the District of Columbia Circuit (Court of Appeals) affirmed the [decision](#) of the United States District Court for the District of Columbia (District Court) to dismiss a joint lawsuit of the Investment Company Institute (ICI) and the U.S. Chamber of Commerce (Chamber) against the Commodity Futures Trading Commission (CFTC). The ICI and Chamber lawsuit alleged that the CFTC violated the Administrative Procedure Act (APA) by adopting amendments, in February 2012, to narrow the scope of relief from registration as a commodity pool operator (CPO) that is afforded to advisers to registered investment companies by CFTC [Rule 4.5](#). In dismissing the lawsuit brought by the ICI and the Chamber, the Court of Appeals upheld the District Court's finding that the CFTC's amendments to Rule 4.5 were not arbitrary and capricious. The Court of Appeals' decision is available [here](#).

Advisers to registered investment companies not meeting the narrowed conditions for exclusion from CPO registration under CFTC Rule 4.5 were required to register as CPOs as of January 1, 2013. However, such advisers have largely been exempt from compliance obligations for registered CPOs pending final CFTC rules that are intended to harmonize CFTC and Securities and Exchange Commission (SEC) requirements relating to, among other things, investor disclosure, reporting and recordkeeping. Advisers to registered investment companies that have registered as CPOs will likely have to begin complying with the applicable CPO compliance obligations later this year once the final harmonization rules are issued and become effective.

### Background

As market participants are aware, CFTC Rule 4.5 excludes advisers to investment companies that are registered as such with the SEC under the Investment Company Act of 1940 (each a registered investment company) from the CPO definition. Previously, CFTC Rule 4.5 afforded a blanket exclusion from the definition of CPO to advisers to registered investment companies. However, in February 2012, the CFTC adopted final rules to, among other things, amend CFTC Rule 4.5 to impose limits on the level of speculative commodity interest (*i.e.*, futures, options and swaps) trading that may be conducted by a registered investment company. Pursuant to the final rules, a registered investment company's commodity interest trading must fall below specified trading thresholds in order for its adviser to qualify for the CFTC Rule 4.5 exclusion from the CPO definition. Advisers to registered investment companies that cannot satisfy the trading thresholds of CFTC Rule 4.5 must register as CPOs unless they are eligible for alternative relief.<sup>1</sup>

### The Court of Appeals' Decision

In their joint lawsuit against the CFTC, the ICI and the Chamber alleged that the CFTC violated the APA in adopting the aforementioned amendments to CFTC Rule 4.5. Specifically, the ICI and the Chamber argued, among other things, that: (1) the CFTC's amendments to CFTC Rule 4.5 were "arbitrary and capricious" because the CFTC failed to consider their necessity; and (2) the CFTC failed to perform an adequate cost-benefit analysis, as required by the APA.<sup>2</sup> On December 12, 2012, the District Court granted summary judgment in favor of the CFTC on the basis that the CFTC's amendments to CFTC

<sup>1</sup> For more information, please see Sutherland's [February 29, 2012](#) and [August 16, 2012](#) Legal Alerts.

<sup>2</sup> For more information, please see Sutherland's [December 14, 2012](#) and [January 17, 2013](#) Legal Alerts.

Rule 4.5 were not arbitrary and capricious and that the CFTC properly evaluated the costs and benefits associated therewith. Subsequently, on December 27, 2012, the ICI and the Chamber filed an [appeal](#) of the District Court's grant of summary judgment. On June 25, 2013, the Court of Appeals affirmed the District Court's decision, stating in its opinion that the CFTC "did not act unlawfully in promulgating" CFTC Rule 4.5. In fact, the Court of Appeals indicated that, among other things, the CFTC's changes to Rule 4.5 followed a congressional shift evidenced in the Dodd-Frank Wall Street Reform and Consumer Protection Act and reflect reasoned decision making.



*If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.*

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