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Practice Group:**Investment
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CFTC Extends Compliance Date for Operators of Funds of Funds

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Background

At the request of the Investment Adviser Association and the Managed Funds Association, the Division of Swap Dealer and Intermediary Oversight (“Division”) of the Commodity Futures Trading Commission (“CFTC”) published CFTC Letter 12-38 (November 29, 2012), which states that the Division will not recommend enforcement action against certain operators of a fund of funds if they do not register as commodity pool operators (“CPOs”) by December 31, 2012. This relief is subject to certain conditions, which are described in more detail below.

As a result of the rescission of CFTC Regulation 4.13(a)(4) and the amendment of CFTC Regulation 4.5 effective December 31, 2012,¹ operators of private funds and of registered investment companies,² respectively, have had to consider whether they must register as CPOs or if they may rely on the exemption in CFTC Regulation 4.13(a)(3) (for private funds) or the amended exclusion in CFTC Regulation 4.5 (for registered investment companies). Both of those exemptions/exclusions require that the funds trade commodity interests only to a *de minimis* extent.³ For operators of funds of funds, it is difficult to determine compliance with trading restrictions because it requires, in most circumstances, that they determine the extent of commodity interest trading by the underlying funds and whether or not the underlying funds will be able themselves to rely on amended CFTC Regulations 4.13(a)(3) or 4.5 going forward. Funds of funds operators may not have real-time visibility into commodity interest trading by underlying fund managers, and those managers may still be determining whether or not they must register as CPOs. Investment in securitization vehicles and real estate investment trusts, and the addition of swaps to the list of commodity interests, further complicates this analysis at the fund of funds level.

In the Amendment Release, the CFTC also announced the repeal of the existing guidance regarding how operators of funds of funds can comply with these *de minimis* restrictions, which had been set forth in Appendix A to Part 4 of the CFTC’s regulations. However, the CFTC staff has indicated that operators can continue to rely on the standards in former Appendix A until new guidance is issued.⁴ We understand that the Division staff is working on new funds of funds guidance and that it is expected to be issued in the next month or so.

The relief postpones the compliance date for operators of funds of funds until the later of June 30, 2013 or six months from the date that the Division issues revised guidance on the application of the *de*

¹ *Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations*, 77 Fed. Reg. 11252 (February 24, 2012); correction notice published at 77 Fed. Reg. 17328 (March 26, 2012) (“Amendment Release”).

² Typically, the operator of a registered investment company would be the main adviser to the fund.

³ For more information regarding CFTC Regulation 4.13(a)(3) and amended CFTC Regulation 4.5, please see our prior alerts from [February 16, 2012](#) and [February 17, 2012](#).

⁴ See *Division of Swap Dealer and Intermediary Oversight Responds to Frequently Asked Questions – CPO/CTA: Amendments to Compliance Obligations* (August 14, 2012, as amended) (“FAQ”) (answer to the question under the heading “Funds-of-funds”).

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minimis thresholds in the context of CFTC Regulations 4.5 and 4.13(a)(3).⁵ Thus, firms that can rely on the relief will have at least an additional six months to determine whether or not they must register as CPOs or can rely on CFTC Regulations 4.5 and/or 4.13(a)(3).

The Conditions

In order to claim the relief, the operator of a fund of funds must meet and remain in compliance with the following criteria:⁶

- a. The CPO currently structures its operations in whole or in part as a CPO of one or more “Funds of Funds;”⁷ and
- b. The amount of commodity interest positions to which the Investor Fund is directly exposed does not exceed the levels specified in CFTC Regulation 4.5 or 4.13(a)(3)(ii)(A) or (B); and
- c. The CPO does not know and could not have reasonably known that the Investor Fund’s indirect exposure to commodity interests derived from contributions to Investee Funds exceeds the levels specified in CFTC Regulations 4.5 or 4.13(a)(3)(ii)(A) or (B), either calculated directly, or through the use of Prior Appendix A; and
- d. The commodity pool for which the CPO seeks relief is either:
 - i. an investment company registered as such under the Investment Company Act of 1940; or
 - ii. compliant with the provisions of CFTC Regulation 4.13(a)(3)(i), (iii) and (iv).⁸

With respect to condition (c), it is not completely clear what due diligence a manager of a fund of funds must perform to confirm that it “does not know and could not have reasonably known” whether commodity interest trading calculated directly or through the use of former Appendix A exceeds either of the relevant *de minimis* tests. One way of satisfying this requirement would be to rely on information provided by underlying fund managers in response to questionnaires. Another way would be to rely on offering documents, financial statements and/or portfolio position reports and other information received from underlying funds. But these are not necessarily the only ways to satisfy condition (c).

Late on Friday, November 30, 2012, Division staff clarified to one of the authors of this alert that the relief is available not only to firms that are registering now as CPOs, but also to firms that are already registered as CPOs and are relying on CFTC Regulation 4.13(a)(4) for their funds of funds. In addition, the staff clarified that, if a firm operates funds of funds, as well as (1) funds that invest directly in commodity interests but not in other funds and (2) separately managed accounts, the firm

⁵ The relief does not excuse the affected persons from compliance with any other applicable requirements contained in the Commodity Exchange Act (“CEA”) or in the CFTC’s regulations issued thereunder.

⁶ It is important to note that the letter represents the view of the Division only, and does not necessarily represent the position or view of the CFTC or of any other office or division of the CFTC. We understand, however, that the letter was not issued by the Division until each of the CFTC Commissioners had an opportunity to review it.

⁷ This term is not defined in the letter. The letter, however, does describe an operator of a fund of funds as the operator of “a vehicle that holds an interest (“Investor Fund” or “Fund of Funds”) in a separately managed vehicle (“Investee Fund”).” This language seems to imply that a Fund of Funds could invest solely in one underlying fund. We do not believe that the relief is intended, however, to encompass typical master-feeder structures that, in any case, would be unlikely to satisfy condition (c) for claiming the relief.

⁸ These conditions require that (i) interests in the fund of funds be offered and sold in an offering exempt from registration under the Securities Act of 1933, and without marketing to the public in the United States, (ii) fund of funds investors be limited to “accredited investors” and certain other persons, and (iii) the fund of funds not be marketed “as or in a vehicle for trading in the commodity futures or commodity options markets.”

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can rely on the extension (assuming it otherwise meets the conditions) for its funds of funds and register as a CPO and/or commodity trading advisor (or comply with other exemptions) with respect to its other activities.

Claiming the No-Action Relief

The relief is not self-executing. Rather, an eligible CPO must file a claim to perfect the relief. A claim submitted by a CPO will be effective upon filing, so long as the claim is materially complete. Specifically, the claim of no-action relief must:

- a. State the name, main business address, and main business telephone number of the CPO claiming the relief;
- b. State the capacity (*i.e.*, CPO) and the name of the pool(s), for which the claim is being filed;
- c. Be signed by the CPO⁹; and
- d. Be filed with the Division prior to December 31, 2012 via email using the email address dsionoaction@cftc.gov and stating “Fund-of-Funds” in the subject line of such email.

Operators claiming the relief should maintain records of their filings to support their claims for exemption/exclusion and to respond to inquiries from futures commission merchants and other members of the National Futures Association (“NFA”) regarding compliance with NFA Bylaw 1101, which requires NFA members to handle orders only from persons registered under the CEA or exempt therefrom.

What If My CPO Registration Is Already in Process?

NFA is working on a method to assure that a firm’s registration as a CPO is not declared effective prematurely. If a firm has already filed to register as a CPO and can determine that it can take advantage of the relief for all of its business, the firm should, after filing the notice described above, contact NFA staff and ask staff to confirm that its CPO registration will not be declared effective on January 1, 2013.

⁹ This may be accomplished by attaching a signed PDF statement from the CPO.

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