

CFTC Adopts Rule Changes and Rescinds Rule 4.13(a)(4)

The U.S. Commodity Futures Trading Commission ("CFTC") has adopted a set of rule changes designed to assist the CFTC in overseeing the commodities and derivatives markets and assessing the market risk associated with pooled investment vehicles under its jurisdiction.¹ In addition the CFTC has rescinded Rule 4.13(a)(4), an exemption from registration with the CFTC as a commodity pool operator ("CPO") relied on by many non-U.S. operators of commodity pools like hedge funds and other types of "qualified purchaser" funds. However, the CFTC did not rescind the de minimis exemption provided in Rule 4.13(a)(3) as it had proposed to do.

The CFTC elected to rescind the Rule 4.13(a)(4) exemption for non-U.S. commodity pool operators and chose not to adopt an alternative exemption for non-U.S. commodity pool operators at this time. This was despite acknowledging that there had been significant comments arguing against this approach and

acknowledging that the derivatives activities of non-U.S. commodity pool operators are often subject to the oversight of non-U.S. regulators. In support of its determination to proceed with the rescission and not to adopt an alternative exemption, the CFTC made only a brief explanation in the Adopting Release:

Due to the exemptions previously adopted by the [CFTC], and the resulting lack of information regarding the activities of CPOs claiming relief thereunder, the [CFTC] does not yet have a comprehensive view of the positions taken and interests held by currently exempt entities. The [CFTC], therefore, believes that it is prudent to withhold consideration of a foreign advisor exemption until the [CFTC] has received data regarding such firms on Forms CPO-PQR and/or CTA-PR, as applicable, to enable the [CFTC] to better assess the universe of firms that may be appropriate to include within the exemption, should the [CFTC] decide to adopt one. Foreign advisors to pools that meet the criteria of § 4.13(a)(3) will be able to continue to operate pursuant to that exemption, if previously claimed, or file notice of claim of exemption under § 4.13(a)(3). Therefore, the [CFTC] is not providing an exemption of foreign advisors at this time.

The CFTC also adopted rule changes that, among other things: (i) require annual reaffirmation of qualification for certain exemptions within 60 days after each calendar year end; and (ii) introduce systemic risk

¹ *Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations* (Feb. 9, 2012) (the "Adopting Release"), which can be accessed on the CFTC's website at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister020912b.pdf>. The CFTC considers any pooled investment vehicle (regardless of the vehicle's domicile) with one or more U.S. investors that invests in commodity interests anywhere in the world to be a commodity pool subject to its jurisdiction, regardless of any non-U.S. regulations which may also apply. Commodity interests include exchange traded futures and options on futures and, when new rules become effective, swaps (a defined term which includes most types of over-the-counter derivatives).

reporting requirements in the form of regular reports on Forms CPO-PQR and CTA-PR.²

Impact of the Rescission of Rule 4.13(a)(4)

CPOs relying on the unlimited trading exemption provided by Rule 4.13(a)(4) as of the effective date of the rescission³ have until 31 December 2012 to come into compliance, which means one of three things:

1. seek to rely on another exemption from the requirement to register as a CPO,⁴ such as:
 - (a) Rule 4.13(a)(3) – This rule exempts from CPO registration the operator of a commodity pool if interests in the pool are exempt from registration under U.S. Securities Act of 1933 (the “Securities Act”) and are not marketed to the public in the United States and where the pool’s use of commodity interests is very limited,⁵ and the interests are offered only to accredited investors,

² The CFTC adopted other changes, including amendments to Rule 4.5 and the rescission of relief from the certification requirement for financial statements, which are not discussed in this *DechertOnPoint*.

³ The rescission will be effective 60 days after the publication of the Adopting Release in the *Federal Register*.

⁴ The CFTC has granted exemptive relief on a case-by-case basis to certain CPOs that delegate responsibility for compliance with the CFTC rules to a registered CPO, subject to certain conditions.

⁵ In this instance, “very limited” means either: (a) that the pool’s aggregate initial margin and premiums attributable to commodity options and commodity futures, respectively, do not exceed 5% of the liquidation value of the pool’s portfolio after taking into account unrealized profits and unrealized losses on any such positions it has entered into, provided 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 such 5%; or (b) that the aggregate net notional value of such positions does not exceed 100% of the liquidation value of the pool’s portfolio after taking into account unrealized profits and unrealized losses on any such positions it has entered into. Both tests do not differentiate as to whether the positions are held for *bona fide* hedging purposes or otherwise. 17 C.F.R. § 4.13(a)(3)(ii).

knowledgeable employees, and members of certain categories of “qualified eligible persons” (“QEPs”) defined in CFTC Rule 4.7;⁶

- (b) Rule 30.4 – This rule exempts from CPO registration the operators of non-U.S. investment pools, provided that (i) the pool does not transact future contracts or options on any U.S. futures markets, (ii) the pool is exempt from registration under the U.S. Investment Company Act of 1940 and the pool’s securities are exempt from registration under the Securities Act; and (iii) no more than 10% of the participants in or values of the assets of the pool are held by U.S. investors; or
- (c) Rule 30.5 – This rule exempts from CPO registration the operators of non-U.S. investment pools, provided that, among other things, (i) the pool does not transact future contracts or options on any U.S. futures markets, (ii) the operator files a petition with the NFA representing that it is located outside the United States and does not engage in trading on U.S. futures markets for its U.S. clients and agrees to submit to U.S. jurisdiction, and (iii) the operator enters into a written agreement appointing a U.S. entity as agent for service of process.

2. register with the CFTC as a CPO⁷ and, if desired, claim relief under Rule 4.7 from

⁶ The CFTC amended Rule 4.13(a)(3) to provide guidance as to the notional value of cleared swaps positions and the ability to net swaps cleared by the same designated clearing organisation and to require an annual reaffirmation of the ability to rely on this exemption to be filed within 60 days following each calendar year end.

⁷ A CPO that is unable to qualify for an exemption from registration must (among other things): (i) register with the CFTC through the National Futures Association (“NFA”); (ii) become a member of the NFA; (iii) include specified disclosures (including but not limited to risks, conflicts, fees and costs, and performance) in its pool offering documentation; (iv) comply with certain advertising and promotional material requirements; (v) distribute periodic account statements and reports; (vi) distribute audited annual financial reports; (vii) implement prescribed policies and procedures; and (viii) maintain and make accessible prescribed books and records. Registration as a CPO can take as long as three to four months

certain disclosure, reporting and recordkeeping requirements; or

3. cease operating commodity pools subject to CFTC jurisdiction by either redeeming all U.S. investors or ceasing to trade commodity interests, including exchange traded futures and options on futures and most swaps in transactions anywhere in the world.

The CFTC expects CPOs with respect to commodity pools formed after the effective date of the rescission to comply with the CFTC's regulations upon formation and commencement of operations.⁸

Systemic Risk Reporting on Forms CPO-PQR and CTA-PR

The CFTC has also adopted new CFTC Rule 4.27, requiring registered CPOs and commodity trading advisors ("CTAs") to file Forms CPO-PQR and CTA-PR, respectively, to allow the CFTC to provide systemic risk information to the Financial Stability Oversight Counsel ("FSOC") and other regulators. The new Form CPO-PQR, while similar to the Form PF recently adopted by the U.S. Securities and Exchange Commission ("SEC"), is not co-extensive with the Form PF and is required to be filed at intervals that do not line up exactly with the filing requirements for Form PF, potentially increasing the burden for dual registrants.⁹

since, among other requirements, natural person associates and their supervisors, and certain principals of the CPOs must register with the NFA and satisfy certain proficiency requirements that include taking and passing the National Commodity Futures Examination, known as the "Series 3 Exam" (or, where applicable, a substitute), submitting fingerprints, participating in periodic ethics and other training, and paying fees.

⁸ In other words, a CPO currently relying on Rule 4.13(a)(4) that becomes the CPO of another commodity pool after the effective date will have to either register with the CFTC or seek to rely on another exemption with respect to the new commodity pool, regardless of the transition period allowed with respect to commodity pools for which claimed the Rule 4.13(a)(4) exemption prior to the effective date of the rescission.

⁹ Form PF requires registered investment advisers to disclose certain financial information regarding the private funds they manage for use by FSOC in monitoring systemic risk. Investment advisers exempt from registration with the SEC are not required to file

Filing Deadlines for Forms CPO-PQR and CTA-PR

The CFTC has also attempted to address the burden of regulatory compliance by balancing its concerns regarding systemic risk with the cost of compliance obligations. As such, the CFTC has proposed a tiered system of regulation, with more frequent and detailed disclosures required for CPOs with over \$150 million in assets under management ("AUM"), and additional disclosures for CPOs with over \$1.5 billion in AUM, as detailed on the next page.

CTAs

All registered CTAs are required to file a Form CTA-PR, which is solely demographic information, each year within 45 days of the calendar year end. The first such filings will be due 14 February 2013.

Contents of Form CPO-PQR

Schedule A of Form CPO-PQR seeks basic identifying information about the CPO, each of the commodity pools it operates and the service providers used. Part 1 requires the disclosure of general information, including the CPO's name and assets under management. Part 2 requires disclosure of information regarding each of the pools operated by the CPO, including monthly performance, and redemption terms and restrictions. A separate Part 2 must be filed for each pool advised by the CPO.

Schedule B of Form CPO-PQR requires more detailed disclosure concerning the pools operated by the CPO, including investment strategy, borrowings and types of creditors, counterparty credit, exposure, trading and clearing mechanisms and a schedule of investments.

Schedule C of Form CPO-PQR is composed of two parts and is required only for the largest CPOs. Part 1 requires aggregate information concerning the pools advised by the CPO, including a geographical breakdown of the pools' investments and the pools' turnover. Part 2 requires similar disclosure for pool with a net asset value of \$500 million or more advised by the CPO (either individually or when aggregated with certain parallel pool structures), as

Form PF, but if they are also registered with the CFTC as a CPO they will have to complete all of the applicable CFTC Form CPO-PQR. Investment advisers registered with both the SEC and the CFTC are only required to file Schedule A of the Form CPO-PQR to the extent that all reportable commodity pools have been reported on the investment adviser's Form PF.

well as additional disclosure including collateral practices of the pool, liquidity information, counterparty credit exposures, risk metrics, borrowing information, investor composition, financing liquidity information and duration.

accordance with U.S. generally accepted accounting principles.



Form CPO-PQR requires all figures reported to be in U.S. dollars and presented and computed in

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CPOs				
	PQR Schedule A	PQR Schedule B	PQR Schedule C	First Filing Due
CPO with \$1.5 billion or greater AUM	Quarterly filing within 60 days of each calendar quarter end	Quarterly filing within 60 days of each calendar quarter end	Quarterly filing within 60 days of each calendar quarter end	If over \$5 billion of AUM as of 30 June 2012, 29 November 2012
				If less than \$5 billion of AUM as of 30 June 2012, 1 March 2013
CPO with less than \$1.5 billion and \$150 million or greater AUM	Annual filing within 90 days of calendar year end	Annual filing within 90 days of calendar year end	1 April 2013 (since 31 March is a Sunday)
CPO with less than \$150 million AUM	Annual filing within 90 days of calendar year end	1 April 2013 (since 31 March is a Sunday)

Practice group contacts

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