# Investment Funds Alert

## CFTC Proposes to Rescind Key Exemptions and Adopt a New Reporting Regime

February 28, 2011

The Commodity Futures Trading Commission (CFTC) recently proposed several changes to its regulations to conform with the regulatory environment after the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Among other things, the proposed changes to the CFTC regulations would—

- rescind the de minimis exemption from registration in Regulation 4.13(a)(3) and the unlimited trading exemption from registration in Regulation 4.13(a)(4) on which many fund managers commonly rely
- require that commodity pool operators (CPOs) and commodity trading advisors (CTAs) file new reports through the National Futures Association (NFA) on Form CPO-PQR (for CPOs) or form CTA-PR (for CTAs), which would be similar to Form PF recently proposed by the Securities and Exchange Commission (SEC) and the CFTC
- modify the criteria for exemption for registered investment companies and other specified persons in Regulation 4.5
- require a filing with the NFA in order to perfect the exemption under Regulation 4.5
- require CPOs receiving relief from disclosure, reporting and recordkeeping obligations under Regulation 4.7 to provide certified financial statements to pool participants. In addition, registered CPOs and CTAs under contract to persons that trade swaps and that do not use the above-referenced exemption for disclosure relief would be required to include a new disclosure statement in their risk disclosures.

## Rescission of Regulation 4.13(a)(3) and (4)

Since the adoption of Regulation 4.13(a)(3) and (4)[1] in 2003, fund sponsors, especially managers of hedge and private equity funds, have frequently used the exemptions in Regulation 4.13(a)(3) and 4.13(a)(4) to avoid registration with the

[1] Regulation 4.13(a)(3) exempts CPOs from registration with the CFTC with respect to a pool if among other things, the applicable pool's margin relating to its commodity interest positions is not more than 5 percent of the liquidation value of the pool's portfolio, or the aggregate net notional value of its commodity interest positions is not more than the liquidation value of the pool's portfolio. Regulation 4.13(a)(4) exempts CPOs from registration with the CFTC with respect to a pool if, among other things, all of the investors in the relevant pool are certain types of qualified eligible persons (including qualified purchasers, non-United States persons and certain industry professionals) or institutional accredited investors.

CFTC as CPOs and compliance with the CFTC's rules.[2] The CFTC has proposed to rescind the above exemptions due to changes in the regulatory environment after the passage of the Dodd-Frank Act. Following the rescission of Regulation 4.13(a)(3) and (4), funds would be required to either stop trading in commodity futures, retail foreign exchange contracts and most swaps or register the sponsor with the CFTC as a CPO. CPOs that choose to register with the CFTC may still use Regulation 4.7 or CFTC Advisory 18-96 for certain disclosure, reporting and recordkeeping relief, but would be subject to other compliance obligations for CPOs set forth in the CFTC regulations.

## Reporting Requirements for CPOs and CTAs

The CFTC proposed a reporting regime that would be similar to the Form PF regime that the SEC and CFTC jointly proposed recently. All registered CPOs would be required to file Form CPO-CQR, and all registered CTAs would be required to file Form CTA-PR. As with the SEC's reporting regime, the amount of information collected would increase if the CPO's or CTA's assets under management (AUM) are $150 million or more and again if the AUM are $1 billion or more.

### Form CPO-CQR

Form CPO-CQR would be broken into the following schedules—

- Schedule A, which all registered CPOs would be required to file
- Schedule B, which registered CPOs with more than $150 million in AUM would be required to file
- Schedule C, which registered CPOs with more than $1 billion in AUM (such a CPO a "Large CPO") would be required to file.

Much of the information is duplicative of Form PF, so registered CPOs to private funds that file Form PF would not be required to file schedules B or C of Form CPO-PQR.

Schedule A of Form CPO-PQR would collect information regarding the CPO and each pool that would be similar to the information in current Form PQR and the base information in Schedule 1 of Form PF, including identifying information regarding the CPO and the pools it operates, information regarding material service provider relationships, AUM, rates of return, positions in various types of investments if the investments constitute 5 percent or more of the pool's net asset value, performance information, redemptions and gates. Every registered CPO would be required to file Schedule A of Form CPO-PQR within 15 days after the end of the calendar quarter.

A separate Schedule B of Form CPO-PQR would be required for each commodity pool that a registered CPO operates that is not a private fund. Schedule B would require information regarding investment strategies, algorithms, number and concentration of pool participants, credit counterparty exposure, trading counterparty exposure and trading and clearing mechanisms. Registered CPOs with $150 million or more in AUM, but less than $1 billion, would be required to complete Schedule B annually within 90 days after the end of the calendar year, and Large CPOs would be required to complete Schedule B within 15 days after the end of the calendar quarter.

In addition, Large CPOs would be required to complete Part 1 of Schedule C within 15 days after the end of each calendar quarter. Part 1 of Schedule C would require certain aggregate information regarding the market value of the assets invested,[3] including derivative securities, turnover frequency and maturity of debt. If the Large CPO operates a pool with assets, together with similar pools or managed accounts, of $500 million or more, it also would also be required to complete Part 2 of Schedule C for each such pool, which would require fund-by-fund disclosure of the

---

[2] The CFTC and NFA take the position that a pooled investment vehicle, such as a hedge fund, that invests in commodities futures contracts to any extent should be considered a commodity pool, thus subjecting its operator to registration as a CPO and its adviser to registration as a CTA, unless an exemption is available.

[3] The form asks for separate disclosure of the amount invested on a long and a short basis.

 

information in Part 1 of Schedule C along with information regarding geographic exposure, liquidity of assets, concentration of positions, collateral practices, risk metrics, financial information, value at risk for each month, borrowings information, market sensitivity and investor composition and liquidity.

### Form CTA-PR

Form CTA-PR would, like Form CPO-PQR, be broken into schedules—Schedule A, which all registered CTAs would be required to file, and Schedule B, which registered CTAs that direct pool assets equal to $150 million or more in AUM would be required to file.

Schedule A of Form CTA-PR would collect general information regarding the CTA and the pool assets, the number of trading programs and the total assets directed by the CTA. Schedule A would be required to be filed by the CTA within 15 days after the end of the quarter. A separate Schedule B of Form CTA-PR would be required for each commodity pool advised by the CTA and would elicit information regarding the pool, including its positions, performance and trading strategy regarding each trading program, the percentage of the pool's assets that are directed by the CTA, the services and the concentration of pool assets. CTAs to private funds that file Form PF with the SEC would not be required to file Schedule B of Form CTA-PR.

## Changes to the Conditions to Regulation 4.5

Regulation 4.5 provides an exemption from registration as a CPO to, among other persons, investment companies registered with the SEC under the Investment Company Act of 1940. Prior to 2003, registered investment companies were required to represent that the initial margin and premiums to establish commodity futures positions and options thereon for other than bona fide hedging purposes were limited to 5 percent of the liquidation value of the investment company and that the investment company would not market the fund as a commodity pool to the public. The CFTC proposed to return to the pre-2003 regulations in order to reduce opportunities for regulatory arbitrage.

## Annual Recertification

The CFTC also proposed that persons who have previously filed for exemptions under Regulation 4.5, 4.13 and 4.14 recertify their exempt status on an annual basis. The CFTC is proposing that recertification filings be made through the NFA's electronic systems within 30 days after the end of the year.

## Proposed Changes to Regulation 4.7

Regulation 4.7 provides relief from disclosure, reporting and recordkeeping obligations to which registered CPOs and CTAs are otherwise subject so long as the pool is privately offered to Qualified Eligible Persons (QEPs). Regulation 4.7 currently allows annual reports to pool participants not to be certified by a certified public accountant. The CFTC proposed to change the conditions of Regulation 4.7, so that CPOs would be required to have financial statements in an annual report certified.

## Conclusion

The proposed rule changes would result in a significant new regulatory burden, especially for funds that only incidentally trade in commodity futures. The proposed changes to the exemptions in regulations 4.13 (a)(3) and (4) would likely include a transition period, the length of which is still being considered.

 

## CONTACT INFORMATION

**If you have any questions concerning this alert, please contact —**

**Mark H. Barth**
mbarth@akingump.com
212.872.1065
New York

**J.P. Bruynes**
jpbruynes@akingump.com
212.872.7457
New York

**Eliot D. Raffkind**
eraffkind@akingump.com
214.969.4667
Dallas

**Simon W. Thomas**
swthomas@akingump.com
44.20.7012.9627
London

**Ying Z. White**
ywhite@akingump.com
86.10.8567.2212
Beijing

**David M. Billings**
dbillings@akingump.com
44.20.7012.9620
London

**Prakash H. Mehta**
pmehta@akingump.com
212.872.7430
New York

**Fadi G. Samman**
fsamman@akingump.com
202.887.4317
Washington, D.C.

**Stephen M. Vine**
svine@akingump.com
212.872.1030
New York

 