

Investment Funds Alert

CFTC Rescinds Key Exemption from CPO Registration

February 9, 2012

On February 9, 2012, the Commodity Futures Trading Commission (CFTC) voted to approve several final changes to its regulations in order to increase its oversight of funds trading futures.¹ Most importantly, the CFTC adopted its prior proposal to rescind the unlimited trading exemption from commodity pool operator (CPO) registration set forth in Regulation 4.13(a)(4) on which many fund managers, including many commodity fund managers, commonly rely.

The CFTC did not, however, rescind the de minimis exemption from CPO registration set forth in Regulation 4.13(a)(3).² The CFTC revised the de minimis thresholds in Regulation 4.13(a)(3) to explicitly include swaps in their computation and to require an annual reaffirmation of the exemptive notice filing with the National Futures Association (NFA).

Rescission of Regulation 4.13(a)(4)

Since the adoption of Regulation 4.13(a)(4) in 2003, fund sponsors, especially managers of hedge funds with only qualified purchaser investors, have frequently used the exemption in Regulation 4.13(a)(4) to avoid both registration with the CFTC as CPOs and compliance with the CFTC's rules.³ In view of the increase in regulatory supervision after the financial crisis, the CFTC has rescinded this exemption. Operators of funds currently relying on the 4.13(a)(4) exemption will be required to either: (i) stop trading in commodity futures, retail foreign exchange contracts and most swaps; (ii) limit such trading and seek to qualify under Regulation 4.13(a)(3) and file for such exemption with the NFA; or (iii) register the sponsor with the CFTC as a CPO. Managers that choose to register with the CFTC may still use Regulation 4.7⁴ or CFTC Advisory 18-96 for certain disclosure, reporting and recordkeeping relief, but will be subject to other compliance obligations for CPOs set forth in the CFTC regulations.

¹ In addition to the change to Regulation 4.13, the CFTC has also adopted new reporting requirements that will be discussed in a forthcoming client alert.

² 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)(3) also requires that: (i) the pool be privately offered; (ii) the pool not be marketed as a vehicle for trading commodity futures; and (iii) all of the investors in the relevant pool be certain types of qualified eligible persons (including qualified purchasers, non-United States persons and certain industry professionals), accredited investors, knowledgeable employees or certain other types of investors.

³ The CFTC and National Futures Association 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 commodity trading advisor (CTA), unless an exemption is available.

⁴ The CFTC rulemaking also impacts CPOs that rely on Section 4.7, as such CPOs will now need to file audited financial statements for each pool they operate with the NFA within 90 days of such pool's fiscal year-end.



Conclusion

The rescission of the exemption will result in a significant new regulatory burden for “qualified purchaser” funds that engage in more than de minimis commodity futures trading. The elimination of the Regulation 4.13 (a)(4) exemption includes a transition period until December 31, 2012, for CPOs currently relying on 4.13(a)(4) that will allow firms needing to register as CPOs enough time to complete the registration process, including having their associated persons take and pass the Series 3 examination or possibly an alternative exam for certain individuals.⁵ A CPO may no longer file a 4.13(a)(4) notice of exemption after the effectiveness of the rescission, 60 days after the publication in the *Federal Register*.

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
jpbuynes@akingump.com
212.872.7457
New York

Robert M. Griffin
bgriffin@akingump.com
971.2.406.8500
Abu Dhabi

Eliot D. Raffkind
eraffkind@akingump.com
214.969.4667
Dallas

Simon Thomas
swthomas@akingump.com
44.20.7012.9627
London

David M. Billings
dbillings@akingump.com
44.20.7012.9620
London

Jason M. Daniel
jdaniel@akingump.com
214.969.4209
Dallas

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

⁵ For example, if an “associated person” has been registered or licensed to solicit customer business in futures in a jurisdiction outside of the United States (such as by the FSA in the United Kingdom), such person need only take and pass the Series 32.