



## New CFTC Guidance on Registration and Compliance Obligations for CPOs and CTAs

August 23, 2012

On August 14, 2012, the Staff of U.S. Commodity Futures Trading Commission (“CFTC”) released guidance (“CPO/CTA FAQs”)<sup>1</sup> on the registration and compliance obligations of commodity pool operators (“CPO”) and commodity trading advisors (“CTA”). Some key matters covered by the CPO/CTA FAQs include provision of temporary no action relief from registration for newly launched funds, guidance on compliance with the *de minimis* trading exemption under CFTC Rule 4.13(a)(3) and confirmation that fund-of-fund managers may continue to rely on the rescinded “Appendix A” guidance.

In light of the rescission of CFTC Rule 4.13(a)(4)<sup>2</sup> and the inclusion of swaps<sup>3</sup> within the meaning of “commodity pool” and “commodity interests,” fund managers operating private funds deemed to be commodity pools, or providing advice relating to commodity interests, must now assess the registration requirements for CPOs and/or CTAs, and any available exemptions from such registration.<sup>4</sup> This Memorandum highlights the key responses in the CPO/CTA FAQs relevant to private fund managers.

---

<sup>1</sup> A copy of the CPO/CTA FAQs is available at:

[http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/faq\\_cpocta.pdf](http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/faq_cpocta.pdf).

<sup>2</sup> From August 8, 2003 until February 9, 2012, operators of commodity pools that relied on the 3(c)(7) exemption from registration under the Investment Company Act of 1940, as amended (the “Investment Company Act”) (*i.e.*, investment vehicles that limited their investors to “qualified purchasers” as defined under the Investment Company Act), and certain other categories of pools, were eligible for an exemption from registration as CPOs pursuant to Rule 4.13(a)(4), an exemption that required a short electronic filing. This exemption can no longer be claimed following April 24, 2012, and can no longer be relied on as of December 31, 2012.

<sup>3</sup> The CFTC and the U.S. Securities and Exchange Commission (“SEC”) published final rules defining the term “swap” on August 13, 2012, with an effective date of October 12, 2012. See “Further Definition of ‘Swap,’ ‘Security-Based Swap,’ and ‘Security-Based Swap Agreement’; Mixed Swaps; Security-Based Swap Agreement Recordkeeping,” CFTC and SEC Joint Final Rule; Interpretations; Request for Comment on an Interpretation, 77 Fed. Reg. 48208 (August 13, 2012). See also our August 17, 2012 memorandum, *CFTC and SEC Publish Key Swap Product Definition Rules under Dodd-Frank, Starting a Countdown to Compliance* (the “August 17 Memorandum”), available at: <http://www.simpsonthacher.com/content/publications/pub1448.pdf>.

<sup>4</sup> For further explanation, see our April 16, 2012 memorandum, *Fund Managers Alert: CFTC Rescinds Exemptions and Expands its Regulations* (the “April 16 Memorandum”) available at: <http://www.simpsonthacher.com/content/Publications/pub1402.pdf>.

## TEMPORARY NO ACTION RELIEF AVAILABLE FOR NEWLY LAUNCHED FUNDS

The CFTC issued a no-action letter on July 10, 2012 (the “Letter”)<sup>5</sup> providing, in part, relief for certain fund managers from compliance with registration as a CPO or as a CTA **until December 31, 2012**. Fund managers to private funds trading in commodity interests that are launched after July 10, 2012<sup>6</sup> will have until December 31, 2012 to assess their CPO/CTA registration obligations. The CPO/CTA FAQs confirm availability of this relief. The relief provided by the Letter is not self-executing. Eligible CPOs and CTAs must file a claim for the relief directly with the CFTC, which, if materially complete, will be effective upon filing.<sup>7</sup>

## COMPLIANCE WITH CFTC RULE 4.13(a)(3)

The CPO/CTA FAQs provide some welcome guidance on compliance with the *de minimis* trading exemption under CFTC Rule 4.13(a)(3)<sup>8</sup>. The key items of guidance are as follows:

---

<sup>5</sup> A copy of the Letter is available at:

<http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-03.pdf>.

<sup>6</sup> CPO registration relief in respect of a private fund launched after July 10, 2012 requires that: (a) interests in the pool are exempt from registration under the Securities Act of 1933, as amended (the “Securities Act”), and such interests are offered and sold without marketing to the public of the U.S.; and (b) the CPO reasonably believes, at the time of investment, that: (i) each natural person participant is a “qualified eligible person,” under CFTC Rule 4.7(a)(2), which includes a “qualified purchaser” under the Investment Company Act; and (ii) each non-natural person participant is a “qualified eligible person,” under CFTC Rule 4.7 (i.e., a “qualified purchaser” under the Investment Company Act), or an “accredited investor” as defined in Rules 501(a)(1)-(3), (a)(7) and (a)(8) of the Securities Act.

CTA registration relief in respect of a private fund or registered investment company launched after July 10, 2012 requires that either (x) the CTA’s commodity interest trading advice is directed solely to, and for the sole use of, the funds that it operates; or (y) the CTA’s commodity interest trading advice is directed solely to, and for the sole use of, pools operated by CPOs who claim an exemption from CPO registration under CFTC Rules 4.13(a)(1), (a)(2), (a)(3), (a)(4) or 4.5, or under no-action relief as provided for in the Letter.

<sup>7</sup> The claim of no-action relief must: (a) state the name, main business address and main business telephone number of the CPO or CTA claiming the relief; (b) state the capacity (i.e., CPO, CTA or both) for which relief is claimed, and, where applicable, the name of the pool(s) for which the claim is being filed; (c) be electronically signed by the CPO or CTA; and (d) be emailed to [dsionoaction@cftc.gov](mailto:dsionoaction@cftc.gov) prior to the date upon which the CPO or CTA first engages in business that would otherwise require registration as such.

<sup>8</sup> CFTC Rule 4.13(a)(3) *de minimis* exemption provides that a CPO is not required to register with respect to a pool that (i) issues interests that are exempt from registration under the Securities Act and are offered without marketing to the public in the United States and (ii) also meets *one* of the following two tests:

- **5% Test:** the aggregate initial margin and premiums (including the required minimum security deposit for retail forex transactions) required to establish its commodity interest positions (determined at the time the most recent commodity interest position was established) does not exceed 5% of the liquidation value of its portfolio (after taking into account the unrealized profits and losses on such positions); *or*

- A fund manager may rely on CFTC Rule 4.13(a)(3) with respect to a fund that will predominantly invest in non-derivatives even when the first position is a swap. The fund manager will have a “reasonable time” to comply with the trading limitations set forth in CFTC Rule 4.13(a)(3).
- Swaps will only be included in the calculation of “commodity interest” as of December 31, 2012. All swaps entered into prior to December 31, 2012 will be included in such calculation.
- Compliance with the trading limits of CFTC Rule 4.13(a)(3) is required only when each new position is established.
- The “liquidation value” of a fund includes all cash held by the fund, not only the aggregate liquidation value of the fund’s positions.
- Commodity options with the same underlying commodity may be netted across designated contract markets and foreign boards of trade.
- Notional value of a swap is the amount reported by the reporting counterparty as the notional amount under Part 45 of the CFTC rules.

#### **TRANSITION FROM CFTC RULE 4.13(a)(4) TO CFTC RULE 4.13(a)(3)**

With the rescission of the CFTC Rule 4.13(a)(4) exemption, many fund managers will need to transition from a CFTC Rule 4.13(a)(4) exemption to a CFTC Rule 4.13(a)(3) exemption. The CPO/CTA FAQs provide guidance on the mechanics of this transition. To make this transition, the fund manager must submit a written request to the U.S. National Futures Association (the “NFA”) to withdraw the manager’s CFTC Rule 4.13(a)(4) exemption with respect to each relying fund. The NFA will then contact the fund manager when the exemption has been withdrawn. After the withdrawal has been finalized, the fund manager may then file the new CFTC Rule 4.13(a)(3) exemption electronically for each fund.<sup>9</sup> Notice of the change of the exemption must also be provided to investors of each fund.

#### **FUND-OF-FUNDS ANALYSIS APPLICABLE TO THE DE MINIMIS TRADING EXEMPTION UNDER CFTC RULE 4.13(a)(3)**

The CPO/CTA FAQs confirmed that fund-of-fund managers relying on CFTC Rule 4.13(a)(3) may continue to rely on Appendix A until the CFTC adopts revised guidance. Appendix A provided limited guidance to fund-of-fund managers relying on CFTC Rule 4.13(a)(3) by setting forth six hypothetical fact patterns which demonstrated when a fund-of-funds manager could rely on the *de minimis* exemption.<sup>10</sup>

- 
- 100% Test: the aggregate net notional value of the fund’s commodity interest positions (determined at the time the most recent commodity interest position was established) does not exceed 100% of the liquidation value of its portfolio (after taking into account the unrealized profits and losses on such positions).

<sup>9</sup> Further guidance on the mechanics of the transition is expected from the NFA.

<sup>10</sup> Appendix A entitled “Guidance on the Application of Rule 4.13(a)(3) in the Fund-of-Funds Context” was deleted by certain amendments to the CFTC Part 4 Rules. For a copy of the Appendix A, please refer to the NFA’s website or contact a member of the Firm’s Private Funds Group.

**TRANSITION FROM CFTC RULE 4.13(a)(4) TO CFTC RULE 4.7**

In light of the rescission of the CFTC Rule 4.13(a)(4) exemption, managers of private funds that do not meet the requirements of the CFTC Rule 4.13(a)(3) exemption will need to register with the CFTC and, if eligible, transition to reliance of the CFTC Rule 4.7 exemption. To claim the CFTC Rule 4.7 exemption, the CPO/CTA FAQs provide that private fund managers of existing funds that operated pursuant to CFTC Rule 4.13(a)(4) will not be required to reaffirm that all investors in such existing fund continue to meet the qualified eligible person standard (the “QEP standard”). Nonetheless, new participants in the existing fund will need to meet the QEP standard at the time of investment in order for the fund to continue to meet the requirements of the CFTC Rule 4.7 exemption.<sup>11</sup>

**CONSEQUENCES FOR MANAGERS OF FUNDS THAT TRADE IN COMMODITY INTERESTS**

Managers<sup>12</sup> of funds in which the commodity interest exposure is only to swaps, and which did not make any exemptive filings or do not qualify for the temporary no-action letter relief noted above, should assess their CPO/CTA status in the near future (and in no event later than October 12, 2012, when the definition of “swap” takes effect.<sup>13</sup>) As a first step, fund managers should gather a list of all derivative transactions engaged in by the fund (or with respect to which the fund managers are providing advice) in order to determine whether such transactions are CFTC-regulated swaps that would trigger the CPO/CTA analysis. Further guidance in respect of this evolving regulatory landscape will need to continue to be monitored.

For certain fund managers, the key compliance deadline for CPO/CTA registration is December 31, 2012:

<p><b>December 31, 2012</b></p>	<ul style="list-style-type: none"> <li>• Reliance on CFTC Rule 4.13(a)(4) ends</li> <li>• Reliance on no-action relief as provided for in the Letter ends</li> <li>• Swaps are included in the threshold calculations for the CFTC Rule 4.13(a)(3) <i>de minimis</i> exemption</li> </ul>
---------------------------------	---

However, for managers that are currently not relying on CFTC Rule 4.13(a)(4), the deadline for CFTC Rule 4.13(a)(3) filing or registration, unless further guidance is issued by the CFTC, is October 12, 2012.

<sup>11</sup> To claim the CFTC Rule 4.7 exemption, a manager of a fund must first register with the CFTC as a CPO and/or CTA. Registration typically takes about six to eight weeks. Once registered, the CPO and/or CTA may claim the exemption by filing an electronic notice if the interests in the fund are offered only to QEPs. For more information regarding registering as a CPO and CTA, see the April 16 Memorandum.

<sup>12</sup> This includes non-U.S. fund managers and U.S. and non-U.S. managers to fund-of-funds structures.

<sup>13</sup> See the August 17 Memorandum.

For more information about any of the foregoing, please contact a member of the Firm's Private Funds Group.

Olga Gutman  
+1 (212) 455-3522  
[ogutman@stblaw.com](mailto:ogutman@stblaw.com)

Dorothy Mehta  
+1 (212) 455-3175  
[dorothy.mehta@stblaw.com](mailto:dorothy.mehta@stblaw.com)

Ekwutozia Nwabuzor  
+1 (212) 455-3239  
[enwabuzor@stblaw.com](mailto:enwabuzor@stblaw.com)

*This memorandum is for general information purposes and should not be regarded as legal advice. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all of our partners, as well as our recent memoranda, can be obtained from our website, [www.simpsonthacher.com](http://www.simpsonthacher.com).*

The contents of this publication are for informational purposes only. Neither this publication nor the lawyers who authored it are rendering legal or other professional advice or opinions on specific facts or matters, nor does the distribution of this publication to any person constitute the establishment of an attorney-client relationship. Simpson Thacher & Bartlett LLP assumes no liability in connection with the use of this publication.



## UNITED STATES

### New York

425 Lexington Avenue  
New York, NY 10017  
+1-212-455-2000

### Houston

2 Houston Center  
909 Fannin Street  
Houston, TX 77010  
+1-713-821-5650

### Los Angeles

1999 Avenue of the Stars  
Los Angeles, CA 90067  
+1-310-407-7500

### Palo Alto

2550 Hanover Street  
Palo Alto, CA 94304  
+1-650-251-5000

### Washington, D.C.

1155 F Street, N.W.  
Washington, D.C. 20004  
+1-202-636-5500

## EUROPE

### London

CityPoint  
One Ropemaker Street  
London EC2Y 9HU  
England  
+44-(0)20-7275-6500

## ASIA

### Beijing

3919 China World Tower  
1 Jian Guo Men Wai Avenue  
Beijing 100004  
China  
+86-10-5965-2999

### Hong Kong

ICBC Tower  
3 Garden Road, Central  
Hong Kong  
+852-2514-7600

### Tokyo

Ark Mori Building  
12-32, Akasaka 1-Chome  
Minato-Ku, Tokyo 107-6037  
Japan  
+81-3-5562-6200

## SOUTH AMERICA

### São Paulo

Av. Presidente Juscelino Kubitschek, 1455  
São Paulo, SP 04543-011  
Brazil  
+55-11-3546-1000