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February 2012

## CFTC Issues Final Rules Amending Registration and Compliance Obligations for CPOs and CTAs

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*After a period of public comment relating to certain Commodity Futures Trading Commission (CFTC) proposals released in January 2011, the CFTC issued final rules adopting significant revisions to regulations involving regulatory compliance obligations for Commodity Pool Operators ("CPOs") and Commodity Trading Advisors ("CTAs"). The final rules include, among others, rescinding an exemption that many private fund advisers rely upon to avoid registration and adopting new data collection forms.*

On February 9, 2012, in response to public comments, the CFTC decided to adopt many of the amendments that it previously proposed, with some modifications. The final rules (i) rescind an exemption from CPO registration set forth in CFTC Rule 4.13(a)(4), which many advisers to private funds have relied upon to avoid CPO registration; (ii) significantly impact the ability of registered investment companies to claim an exclusion from the definition of CPO provided under CFTC Rule 4.5; (iii) adopt new data collection forms for CPOs and CTAs; and (iv) require persons relying upon exemptions established by CFTC Rules 4.5, 4.13, and 4.14 to affirm on an annual basis the accuracy of their original notice of exemption. While the CFTC had proposed to rescind the exemption from CPO registration under Rule 4.13(a)(3) (i.e., the "de minimis" futures activity exemption), the final rules have kept that exemption in place.

### Rescission of Registration Exemption for Pools Offered to Qualified Eligible Persons

The final rules rescind the exemption from registration as a CPO set forth in CFTC Rule 4.13(a)(4). This Rule currently provides an exemption from registration for pools whose participants are either qualified eligible persons ("QEPs") or institutional accredited investors. Notably, the final rules also amend the exemption from registration as a CTA for persons registered with the Securities and Exchange Commission (the SEC), or any state (or exempt from registration or excluded from the definition of investment adviser) who advise commodity pools whose CPOs rely upon either of CFTC Rules 4.13(a)(3) or 4.14(a)(4). This amendment removes the CFTC Rule 4.14(a)(4) reference from such CTA registration exemption.

CPOs previously claiming exemption under CFTC Rule 4.13(a)(4) are now required to register as a CPO (unless able to avail themselves of another exemption from registration) by December 31, 2012. All other CPOs will be required to abide by the rescission of CFTC Rule 4.13(a)(4) upon the effective date of the final rules.

### Certified Audited Financial Statements Now Required for Registration "Lite" Reporting Relief

The final rules also effect certain amendments to CFTC Rule 4.7 (which provides an exemption from certain regulatory disclosure, recordkeeping, and reporting requirements with respect to registered CPOs and registered CTAs whose pool participants are limited to "qualified eligible persons," as defined in the Rule). Specifically, the final rules (i) incorporate by reference the accredited investor standard set forth in Regulation D under the Securities Act of 1933 (prior to the final rules, CFTC Rule 4.7 directly included the specific terms of the accredited investor standard under Regulation D); and (ii) require CPOs operating any pool pursuant to the relief granted under CFTC Rule 4.7 to have the annual financial statements for such pool certified by a public accountant.

### Registered Investment Company Operators Face Changes to Criteria for Claiming Registration Relief

CFTC Rule 4.5 provides an exclusion from the term CPO for certain operators of trading vehicles registered under the Investment Company Act of 1940 (the "Company Act"). To qualify for the exclusion, operators must now (i) restrict their commodities and futures marketing activity; (ii) limit commodity futures and options activity to bona fide hedging transactions; and (iii) limit certain margins and premiums to 5% of the liquidating value of the applicable portfolio, or satisfy an alternative trading threshold test based upon the net notional value of a registered investment company's futures positions.

Compliance with CFTC Rule 4.5 for registration purposes is required by the later of December 31, 2012 or 60 days after the effective date of final rulemaking further defining the term "swap" (see discussion below regarding swaps transactions). Entities required to register as a result of the CFTC Rule 4.5 amendments will be subject to the CFTC's recordkeeping, reporting, and disclosure requirements set forth in Part 4 of the CFTC's regulations 60 days following the effectiveness of a final rule implementing the CFTC's proposed regulatory compliance harmonization effort with the SEC.<sup>1</sup>

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## No Family Office or Foreign Advisor Exemptions

The final rules note that the CFTC received numerous public comments regarding a possible exemption from CPO registration for family offices, which, presumably, would be similar to the SEC's investment adviser exception for family offices established under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). However, the final rules do not provide such an exemption, with the CFTC claiming that it does not yet have a comprehensive view of the futures positions taken, and interests held, by currently exempt entities. The final rules note that family offices may rely on interpretive letters already issued with respect to registration and compliance relief, and that such family offices may also request additional interpretive relief. The final rules direct the CFTC staff to look into the possibility of adopting a family office exemption in the future.

As with the final rules discussion regarding family offices, the final rules do not provide a separate exemption from CPO registration or compliance with respect to foreign advisers. Consequently, nearly all non-U.S. CPOs that operate a pool with at least one U.S. investor may be required to register with the CFTC (unless such CPOs can claim a separate exemption or rely upon interpretive relief from registration).

## Annual Filing Required to Claim Exemptive Relief

As noted above, the final rules require annual reaffirmation of any claim of exemption or exclusion from registration for CTAs and CPOs. Unlike the CFTC's initial proposal, which would have required annual notice filings based upon the anniversary of the original filing date, the final rules will require CPOs and CTAs to effect such annual notice filings within 60 days of each calendar year end. Compliance with the notice filing requirements begins on December 31, 2012.

## Swaps Transactions and Required Risk Disclosure

During 2011, the CFTC issued a proposal to amend the definition of "commodity interest" in CFTC Rule 1.3 to include swaps. If this proposal is adopted, CPOs and CTAs of pools that engage in swaps transactions would be required to register with the CFTC, absent an available exemption. In furtherance of the CFTC's expanded role in regulating swaps transactions, which is a consequence of the Dodd-Frank Act's required rulemaking, the final rules require CPOs and CTAs to include prescribed risk disclosures in their disclosure documents regarding swaps transactions. The prescribed risk disclosures will be required for all new disclosure documents, and all updates, filed after the effective date of the final rules.

It should also be noted that the CFTC's recent proposal to include swaps within the definition of "commodity interest" (thereby expanding the universe of entities included within the definition of "commodity pool") may further inhibit the ability of managers to meet the "de minimis" thresholds set forth in Rule 4.13(a)(3).

## New Reporting Requirements

The final rules implement new data reporting obligations for CPOs and CTAs on Forms CPO-PQR and CTA-PR, respectively. The reporting obligations required by each of these Forms have been altered in comparison to previous CFTC proposals. The final rules clarify that CPOs that are dually registered as investment advisers with the SEC, and that file Form PF<sup>2</sup> must still file Form CPO-PQR, but will only be required to complete and file Schedule A to such Form, which contains only general identifying information relating to the CPO. The final rules retain the \$150 million assets under management threshold for reporting on Form CPO-PQR, but have revised the threshold for large CPOs (which will be required to report additional information on Schedule C of Form CPO-PQR) from \$1 billion in assets under management, as proposed, to \$1.5 billion in assets under management. The final rules also provide that affiliated entities are permitted, but are not required, to report on a single Form with respect to all affiliates and advised pools. Additionally, where a pool is operated by one or more co-CPOs, the final rules provide that only one CPO should report on the activities of the jointly operated pool, with that CPO disclosing the identities of the co-CPOs.

With respect to funds of funds, the final rules specify that a fund investing in unaffiliated commodity pools is a commodity pool for purposes of the Commodity Exchange Act (the "CEA"), and should not be relieved of any applicable reporting obligations. Accordingly, the final rules add a question to Schedule A of Form CPO-PQR that requests the names of investee funds. The final rules, however, permit a CPO of a fund of funds to exclude any assets invested in the equity interests of other commodity pools or private funds for purposes of determining the CPO's reporting obligations, so long as these assets are treated consistently for purposes of Form CPO-PQR.

CPOs, other than large CPOs, will be required to file Form CPO-PQR on an annual basis (within 90 days of the end of the calendar year), with large CPOs being required to file on a quarterly basis (within 60 days of the applicable reporting period).

With respect to Form CTA-PR, the final rules have adopted only Schedule A of that Form, which will contain basic identifying information and will ask the CTA to disclose the pools under its advisement. Form CTA-PR must be filed on an annual basis within 45 days of the end of each fiscal year.

The effective date for Forms CPO-PQR and CTA-PR is July 2, 2012, while the applicable compliance dates are (i) September 15, 2012, for any CPO having at least \$5 billion in assets under management as of the last day of the most recent fiscal quarter prior to September 15, 2012; and (ii) December 15, 2012 for all other CPOs and CTAs.

## Next Steps

The final rules represent substantial changes that are occurring in the investment management industry. In order to effectively manage these changes to the regulatory landscape, managers should make determinations now as to their obligations with respect to the final rules. Managers should begin by determining whether their advised pools are considered "commodity pools," thereby causing the manager and/or its affiliates to be considered a CPO and/or CTA, particularly in light of the inclusion of swaps activities within such determination.<sup>3</sup> To the extent that a manager falls into one or both definitions, the manager should determine whether its currently claimed or anticipated exemption from registration remains viable and, if not, whether any other exemptions from registration will be applicable (e.g., CFTC Rules 30.4 and 30.5 exempt from registration as a CPO certain operators of non-U.S. investment pools, so long as certain requirements are met). Managers advising pools that rely upon the Section 3(c)(7) exemption from registration under the Company Act, in particular, should assess whether they may be able to avail themselves of the CFTC Rule 4.13(a)(3) "de minimis" CPO exemption, since most of these managers now likely rely upon CFTC Rule 4.13(a)(4).<sup>4</sup>

## Related Publications

[Registration of Related Entities of a Registered Investment Adviser — SEC Issues No-Action Letter Interpretive Guidance 1/25/2012](#)

[Year-End Developments and Compliance Checklist 1/13/2012](#)

[Dodd-Frank Act Rulemaking — SEC and CFTC Release Joint Final Rules Relating to Form PF 11/9/2011](#)

[Dodd-Frank Act Rulemaking: SEC Approves Final Version of Form PF 10/27/2011](#)

[Reminder: Rule 13h-1 \(the Large Trader Reporting Rule\) Compliance Date is Dec. 1, 2011; Effective Date Was Oct. 3, 2011 10/11/2011](#)

[Why Is It So Hard to Launch a Hedge Fund Today? 8/19/2011](#)

[New FINRA Rule 1230\(b\)\(6\): Operations Professionals Must Register and Pass an Examination 7/26/2011](#)

As mentioned above, managers registered as investment advisers with the SEC or any state (or exempt from registration or excluded from the definition of investment adviser) who advise commodity pools whose CPOs rely upon CFTC Rule 4.13(a)(3) may continue to rely upon an exemption from registration as a CTA. Additionally, Section 4m(1) of the CEA provides an exemption from registration as a CTA for any manager that, in the preceding twelve months, has not furnished commodity trading advice to more than 15 persons and that does not hold itself out generally to the public as a CTA. Section 4m(3) provides an exemption from registration as a CTA for a manager (a) that is registered with the SEC as an investment adviser; (b) whose business does not consist primarily of acting as a CTA; and (c) that does not act as a CTA to any pool that is engaged primarily in trading commodity interests.

To the extent that a manager is unable to avail itself of any exemptions, registration will be required, and the manager should begin to prepare for the financial and administrative costs that such registration will entail. Registration as a CPO typically takes two to three months. In order to register as a CPO, a manager must, among other things, (i) submit to the National Futures Association (the NFA) CPO registration form 7-R; (ii) submit to the NFA a non-refundable application fee of \$200; (iii) submit to the NFA annual membership dues of \$750; (iv) submit to the NFA fingerprinting records and application fees of \$85 for each principal and associated person; (v) ensure that certain associated persons meet the Series 3 examination requirement (with limited exemptions); (vi) meet certain ongoing compliance obligations such as ethics training and maintenance of certain compliance policies and procedures; and (vii) undergo periodic examinations by the NFA.

Managers facing registration requirements must also prepare themselves for new reporting requirements implemented with respect to Forms CPO-PQR and CTA-PR, even, notably, managers that are registered as investment advisers with the SEC and that are required to file Form PF. Managers may be able to avail themselves of relief from certain disclosure, recordkeeping, and reporting requirements set forth in CFTC Rule 4.7 (i.e., the so-called "registration lite"). Rule 4.7 is available for pools offered only to QEPs, so long as the manager meets certain requirements, such as preparation and distribution to investors of quarterly statements and filing quarterly reports with the NFA.<sup>5</sup>

Managers who are in the process of launching new pools should begin by operating under the new regime ushered in by the final rules (i.e., managers will not be able to wait until December 2012 to comply with the new registration requirements for new pools).

Lowenstein Sandler's Investment Management Group is available to assist our clients with navigating the exemptions, exclusions, and administrative requirements implemented by the final rules. We note, in particular, that managers to private pools currently relying on the exemption provided by CFTC Rule 4.13(a)(4) should begin promptly the process of preparing for registration (to the extent required) and reporting obligations. We advise our clients to begin this process well before the December 2012 deadline in order to effectively manage any unexpected delays.

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The CFTC's press release announcing the issuance of the final rules may be found [here](#). The text of the final rules may be found [here](#).

Please contact any of the attorneys listed, or any other member of Lowenstein Sandler's [Investment Management Group](#), for further information on the matters discussed herein.

<sup>1</sup> Concurrently with the final rules, the CFTC has issued proposed rules regarding the harmonization of compliance obligations for operators of registered investment companies that are required to register as CPOs. Comments on these proposed rules are due 60 days after their publication in the Federal Register. The proposed rules may be found [here](#).

<sup>2</sup> The Lowenstein Sandler Investment Management Group Alert analyzing Form PF is available [here](#).

<sup>3</sup> A Commodity pool is any pooled investment vehicle with one or more U.S. investors that invests in commodity interests (including futures, options on futures, and swaps).

<sup>4</sup> (Section 3(c)(7) of the Company Act provides an exemption from registration under the Company Act for private funds (including commodity pools), the interests of which are owned solely by "qualified purchasers" and certain "knowledgeable employees," as each term is described under the Company Act).

<sup>5</sup> Managers should note that the universe of qualified participants in pools that are eligible for Rule 4.7 is somewhat more narrow than the universe of qualified participants in pools that were eligible for the Rule 4.13(a)(4) exemption (i.e., Rule 4.13(a)(4) permitted investments by certain entity investors that may not be eligible to invest in a pool eligible for Rule 4.7).

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