

## Alert

### CFTC Staff Issues New FAQ Guidance for CPO, CTA Registration and the “De Minimis” Exemption

August 24, 2012

Effective Dec. 31, 2012, the Commodity Futures Trading Commission (“CFTC”) Rule 4.13(a)(4)<sup>1</sup> exemption from registration as a commodity pool operator (“CPO”) will no longer be available. Private fund managers who rely on this exemption must find an alternative exemption or otherwise register with the CFTC as a CPO. In addition, mutual funds and other registered investment companies will have to comply with new conditions under amended Rule 4.5 if they engage in futures, commodity options or swap transactions.

The CFTC retained the “de minimis” exemption from CPO registration for CPOs of funds that have de minimis futures activity (i.e., either (1) the aggregate initial margin and premiums on commodity interest positions does not exceed five percent of the liquidation value of the fund’s portfolio (including unrealized gains and losses) or (2) the aggregate notional value of such positions does not exceed 100 percent of the liquidation value of the fund’s portfolio (including unrealized gains and losses)).

The CFTC is also imposing new data reporting requirements for registrants under Forms CPO-PQR and CTA-PR.<sup>2</sup>

#### FAQ Guidance

On Aug. 14, 2012, the CFTC staff issued a set of responses to frequently asked questions to clarify rule changes with respect to registration and exemptions for CPOs and commodity trading advisors (“CTAs”). The following is a brief overview of the more notable points:

- **Valuation of Swaps for Net Notional Calculation:** With respect to the net notional threshold for the Rule 4.13(a)(3) de minimis exemption, the CFTC staff is taking the position that the “notional value” is the same as the amount required to be reported by swap counterparties as the notional amount.
- **Special Purpose Vehicles:** Wholly owned subsidiaries of private or registered commodity pools (i.e., SPVs) are themselves commodity pools and would thus need to either meet the de minimis test on their own accord (i.e., by looking directly at the SPV portfolio) or otherwise have the CPO of the SPV register. However, even if the CPO of the SPV would be required to register, it would be exempt from providing certain disclosure documents and financial statements to the pool.

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<sup>1</sup> CFTC Rule 4.13(a)(4), which was adopted in 2003, generally exempted from CFTC registration CPOs of funds whose natural person investors are “qualified eligible persons” (“QEPs”) within the meaning of CFTC Rule 4.7(a)(2) (a category that includes “qualified purchaser” investors in funds offered pursuant to Section 3(c)(7) of the Investment Company Act of 1940) and whose non-natural person investors are either QEPs or “accredited investors” as defined in Securities and Exchange Commission (“SEC”) Regulation D.

<sup>2</sup> Additional details about these changes can be found in SRZ’s July 20, 2012 *Alert*, [Update on Recent CFTC Actions Affecting Fund Managers](#).

- **Form CPO-PQR:** The CFTC staff has stated that no additional guidance with respect to the Form CPO-PQR will be forthcoming until next year. As such, the CFTC staff has indicated that CPOs and CTAs should make “reasonable assumptions consistent with a good faith effort” in their CPO-PQR filings.
- **Exempt Funds Transitioning to 4.7 “Regulation Lite” in 2013:** Funds relying on Rule 4.13(a)(4) that will transition to registering and relying on Rule 4.7 will not be required to reconfirm that all existing investors in the fund are QEPs.
- **Funds of Funds:** The CFTC staff has reaffirmed that the Appendix A guidance (which was removed when the CFTC amended the applicable rules) for funds of funds relying on the de minimis exemptions under Rule 4.13(a)(3) (private funds) or Rule 4.5 (registered funds), can still be relied upon until the CFTC adopts revised guidance. In practice, funds of funds have found compliance with Appendix A guidance to be difficult.
- **Temporarily Exceeding the 4.13(a)(3) De Minimis Thresholds:** The CFTC staff confirmed that a fund would not be in violation of the Rule 4.13(a)(3) exemption if it temporarily crosses the de minimis thresholds so long as the fund is in compliance with the trading threshold at the time a position is established.
- **Applicability of Prior No-Action Letters to Boards of Directors and General Partners:** The CFTC staff has historically issued no-action letters allowing a general partner or board of directors to not register as a CPO if, among other things, it delegates its rights and obligations with respect to the operation of the pool to the investment manager and agrees to a joint and several liability agreement for violations of the Commodity Exchange Act. The CFTC staff has indicated that firms may rely on these no-action letters without seeking independent no-action relief.
- **2012 Annual Report Filings:** While registered CPOs are required to file year-end annual financial reports, the CFTC staff has confirmed that CPOs who are having their exemption withdrawn on Jan. 1, 2013 (and thus registering as of that date) will only be required to file their first annual report for the fiscal year 2013.
- **Bona Fide Hedging Excluded for Registered Funds Relying on the De Minimis Exemption:** While registered funds may exclude bona fide hedging when determining if a fund is below the de minimis thresholds, the CFTC staff has confirmed that bona fide hedging does not extend to derivatives positions used to manage cash and other risk management positions that don’t otherwise meet the definition of bona fide hedging.

For additional details, the full FAQ text can be found 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).

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