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SECURITIES ALERT
FEBRUARY 2012

CFTC Finalizes Changes to CPO and CTA Registration and Compliance Rules

On February 9, 2012, the Commodity Futures Trading Commission ("CFTC") issued final rules that significantly alter the registration and compliance requirements of many commodity pool operators ("CPOs") and commodity trading advisors ("CTAs"). This rule change is expected to affect certain hedge funds and other private fund groups who currently rely on certain registration and reporting exemptions. Specifically, the final rules: (1) rescind CPO exemptions relied upon under CFTC Rule 4.13(a)(4); (2) further limit those CPOs who claim a registration exemption under CFTC Rule 4.5; (3) create new annual reporting requirements for CPOs and CTAs under Rule 4.27; and (4) require additional reporting by CPOs and CTAs claiming registration exemptions under various rules.

CFTC Rescinds Rule 4.13(a)(4) Exemption

The CFTC rescinded the CPO registration exemption existing under CFTC Rule 4.13(a)(4). This rule exempted many private fund groups from registration as a CPO, as long as each investor in the funds at issue certified their status as a qualified eligible person ("QEP"). Many private fund managers and investment advisers currently rely on this exemption to avoid registration and reporting requirements under the Commodity Exchange Act ("CEA"). Fund managers affected by the change who wish to continue trading in futures, options or swaps products must either formally register with the CFTC as a CPO or seek an alternative exemption under the rules. This rescission also affects some managers claiming relief from registration as a CTA. Those CTAs who claimed an exemption under CFTC Rule 4.14(a)(8), based upon the fact that they managed only a fund exempt under Rule 4.13(a)(4), must now formally register or seek an alternative exemption.

For those seeking an alternative, CFTC Rule 4.7 allows for a similar exemption from formal registration, but requires additional disclosures to investors and regulatory agencies. Additionally, Rule 4.13(a)(3) provides an exemption from registration for funds that hold only a "de minimis" position in financial products regulated by the CFTC. In order for a fund to qualify under the "de minimis" standard, the fund's aggregate initial margin and option premiums in such products must not exceed 5% of the fund's liquidation value or the fund's aggregate net notional value of such products must not exceed 100% of the fund's liquidation value.

The rescission of Rule 4.13(a)(4) is effective 60 days after publication in the Federal Register and funds will be required to comply fully with the change by December 31, 2012.

CFTC Narrows Rule 4.5 Exemption

Funds that are registered investment companies under the Investment Company Act of 1940 are now subject to additional requirements in order to qualify for the exemption from registration as a CPO pursuant to CFTC Rule 4.5. Specifically, the positions in financial products regulated by the CFTC must be taken by such funds solely for "bona

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fide" hedging purposes, but such funds may execute additional positions that do not exceed calculations similar to those defined in the "de minimis" exemption of CFTC Rule 4.13(a)(3), described above. As a result, managed futures funds can no longer rely on this exemption from registration. This rule change is effective on the later of December 13, 2012 or 60 days after the term "swap" is fully defined by the CFTC (which has not yet occurred).

CFTC Adds CPO/CTA Reporting Rule 4.27

The CFTC adopted annual disclosure forms for those entities registered as CPOs or CTAs with the CFTC. Registered CPOs must file Form CPO-PQR, which includes three separate schedules. The schedules a fund must file will depend on the assets under management and whether they are dually registered with the SEC. Depending on the schedule, CPOs are required annually to file the forms within 60 or 90 days of the fund's calendar year end date. CTAs must file Form CTA-PR annually within 45 days of the end of their fiscal year. CPOs and CTAs will have the opportunity to request confidential treatment for certain responses on these annual filings. CFTC Rule 4.27 is effective on July 2, 2012, with the first reports due soon after.

Additional Reporting Requirements for Exempted Entities

The CFTC added two separate reporting requirements to surviving CPO and CTA registration exemptions. First, CPOs exempt under Rule 4.7 must provide investors with audited, annual financial statements in accordance with generally accepted accounting principles ("GAAP") and certified by an independent accounting firm. Second, CPOs and CTAs exempt from formal registration under Rules 4.5, 4.13, or 4.14(a)(8) must now file annual affirmative exemption notices with the NFA within 60 days of each calendar year end.

The Securities and Derivatives Litigation and Regulatory Group at Herrick, Feinstein LLP is here to advise you in the coming months as you and your firm adjust to the new registration and reporting requirements. For more information on the issues in this alert, please contact:

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