

> Commodity Pool Operators and Commodity Trading Advisors:

**Key CFTC Registration and Compliance Considerations for
Private Fund Sponsors, Advisors and Personnel**

June 25, 2012

BINGHAM

The logo for Bingham, featuring the word "BINGHAM" in a bold, orange, sans-serif font. A thin vertical orange line extends downwards from the center of the letter "M".

Introduction

In February 2012, the Commodity Futures Trading Commission (the “CFTC”) adopted final amendments to its rules governing commodity pool operators (“CPOs”) and commodity trading advisors (“CTAs”). Among other things, the CFTC determined to rescind Rule 4.13(a)(4) of its regulations, an exemption from CPO registration upon which many sponsors of private funds have relied. The CFTC also determined to impose new reporting requirements for registered CPOs and CTAs. In light of these developments, this outline highlights certain key considerations for private fund sponsors and managers that are evaluating whether they are required to register as CPOs or CTAs or whether they qualify for an exemption from registration.

Under the Commodity Exchange Act (the “CEA”), the CFTC is the federal agency responsible for the regulation of trading in instruments including commodity futures, commodity options, security futures products, retail forex transactions, and other commodity interest transactions in the U.S. markets. The Dodd-Frank Act amended the CEA to expand the CFTC’s jurisdiction to include trading in swaps. (The SEC has jurisdiction over security-based swaps, and the SEC and CFTC share jurisdiction over the limited category of mixed swaps.) For ease of reference, from time to time in this outline we refer generally to these instruments as “commodity interests.”

The CFTC has also adopted regulations governing the registration and ongoing activities of intermediaries in the markets subject to its jurisdiction, including CPOs and CTAs. These firms and their personnel are also subject to the rules and regulations of the National Futures Association (the “NFA”), the self-regulatory organization for futures firms.

While we hope it proves helpful, this outline only speaks in very general terms about the registration and compliance requirements applicable to CPOs, CTAs, and their personnel. As a result, it omits many specific details that may be important to private fund sponsors and advisers considering these matters. Please also note that this outline is not intended as legal advice and should not be relied upon as such. While we do not address the facts and circumstances of particular firms in this outline, we will be pleased to address specific questions at your request.

Although we anticipate supplementing this outline from time to time, its contents are only current as of the date set forth on the cover page.

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PART A

COMMODITY POOL OPERATORS AND THEIR PERSONNEL

I. Background Matters

“Commodity Pool” Definition. The term “commodity pool” refers to any investment trust, syndicate, or similar form of enterprise operated for the purpose of trading commodity interests, including: any future, security futures product, or swap; authorized commodity option or leverage transaction; or retail forex or commodity transactions as further defined in the CEA. Commodity pools can encompass a broad array of entities, including registered investment companies, hedge funds, and other types of private investment funds. The CFTC has not foreclosed the possibility that there can be a single-investor commodity pool.

“Commodity Pool Operator” Definition. The term “commodity pool operator” includes any person engaged in a business that is in the nature of a commodity pool and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in commodity interests, including: any future, security futures product, or swap; authorized commodity option or leverage transaction; or retail forex or commodity transactions as further defined in the CEA. The definition also includes any entity or person that registers with the CFTC as a CPO for whatever reason.

CPO Registration Requirements. Absent an available exemption, a firm that falls within the CPO definition must register as a CPO with the CFTC. The registration process is administered by the NFA. Certain firm personnel will fall within the definitions of “principal” and “associated person” and are also subject to registration or other filing requirements.

Certain exemptions from CPO registration are discussed in Part C of this outline.

II. Registration Requirements for Firms

General Considerations. A firm files for registration as a CPO by using the NFA Online Registration System (“ORS”). The ORS may be accessed at www.nfa.futures.org. In general, the registration process takes 3-4 months. Firms should plan for registration to take somewhat longer at least throughout the balance of 2012, however, because the NFA will likely face resource constraints in dealing with a substantial uptick in new registrations owing to the CFTC’s recent decision to rescind Rule 4.13(a)(4), a commonly-used exemption from CPO registration requirements.

Registration Requirements for Firms. In order to register with the NFA, a firm must take the following steps:

- Complete the online version of Form 7-R, the Firm Application;¹
- Submit a non-refundable application fee of \$200; and
- Pay NFA-mandated CPO membership dues of \$750. (A CPO, like most other registrants under the CEA, is required to be a member of the NFA. Thus, being denied membership in the NFA or being subsequently disciplined by the NFA by being barred from membership is tantamount to being barred from acting as a CPO.)

As part of the registration process, CPOs are required to design and implement a program for complying with the rules and regulations of the CFTC and the NFA. Key topics that must be covered by a firm's compliance program include:

- Ethics training for employees;
- Annual compliance reviews;
- Inspections of branch offices;
- Registration of new employees; and
- Disaster recovery planning.

In addition, firms typically include in their compliance manuals procedures for complying with other CFTC/NFA requirements, particularly the disclosure, reporting, and recordkeeping requirements relating to commodity pools found in Part 4 of the CFTC's regulations. We discuss those requirements below. Firms that are registered with the SEC as investment advisers may be able to incorporate these separate procedures in their existing manuals.

III. Registration and Filing Requirements for Principals and Associated Persons

Principal Status. NFA Registration Rule 101 defines the term "principal" in relevant part as:

- (1) an individual who is:
 - (A) a proprietor of a CPO that is a sole proprietorship;
 - (B) a general partner of a CPO organized as a partnership;
 - (C) a director, president, chief executive officer, chief operating officer, or chief financial officer of a corporation, or a person in charge of a business unit, division or function of a corporation the activities of which would fall within the regulatory jurisdiction of the CFTC (*e.g.*, its

¹ The Form 7-R template is available at <http://www.nfa.futures.org/NFA-registration/templates-and-forms/form7-r.HTML>.

investments in or trading activities with respect to commodity interests would qualify it as a commodity pool); or

(D) a director, the president, chief executive officer, chief operating officer, chief financial officer, manager, or managing member of a limited liability company or limited liability partnership or those members of a limited liability company or limited liability partnership vested with the management authority for the entity, and any person in charge of a principal business unit, division or function subject to regulation by the CFTC; or

(2) an individual who directly or indirectly, through agreement, holding companies, nominees, trusts or otherwise:

(A) is the owner of 10% or more of the outstanding shares of any class of a CPO's stock;

(B) is entitled to vote 10% or more of any class of a CPO's voting securities;

(C) has the power to sell or direct the sale of 10% or more of any class of a CPO's voting securities;

(D) has contributed 10% or more of a CPO's capital;

(E) is entitled to receive 10% or more of a CPO's net profits; or

(F) has the power to exercise a controlling influence over a CPO's activities that are subject to regulation by the CFTC.²

An individual's status as a principal is determined by his ability to control the entity's business activities, his formal title or position with the entity, or his financial or ownership interest in the entity. An individual who, through his conduct or activity, directly or indirectly controls an entity is a principal, regardless of his formal title or financial interest in the entity. An individual who holds a specific position or has a specific title is also a principal, regardless of his ability to control the entity's business.

The definition of "principal" also includes certain entities. Further information on principal status, including examples of personnel and entities who may be required to register as principals, is available in the online NFA rulebook and on the NFA website.³

Principal Filing Requirements. Firm personnel who fall within the definition of "principal" must complete the following steps in connection with their firm registering as a CPO:⁴

² See also CFTC Rule 3.1(a).

³ For the definition of principal, see <http://www.nfa.futures.org/nfamanual/NFAManual.aspx?RuleID=RULE101&Section=8>. For further background on principal status, see <http://www.nfa.futures.org/NFA-registration/principal/index.HTML>.

- Complete online Form 8-R, the Individual Application;⁵
- Submit fingerprint cards;
- Complete the verification of the person's Form 8-R; and
- Pay a non-refundable application fee of \$85.00.

A person need not pay the application fee if he is registered with the CFTC/NFA in any capacity or is listed as a principal of a current CFTC registrant.

Associated Person Status. An individual will be considered an “associated person” of a CPO if that person is associated with the CPO in any capacity as a partner, officer, employee, consultant, or agent (or who has a similar status or performs similar functions), and is involved in the solicitation of funds, securities, or property for a participation in a commodity pool. In addition, a person will be considered an associated person if he supervises any person engaged in those solicitations.⁶ In this regard, the NFA has indicated that the “associated person” designation generally applies to any person in the “supervisory chain-of-command” and not just the direct supervisor of a person soliciting funds, securities, or property.

Associated Person Registration Process. Firm personnel who fall within the definition of “associated person” must register with the NFA by completing the following steps:⁷

- Complete online Form 8-R, the Individual Application;
- Submit fingerprint cards;
- Satisfy the NFA's Proficiency Requirements (described below);
- Complete the verification of the person's Form 8-R; and
- Pay a non-refundable application fee of \$85.00.

A person need not pay the application fee if he is registered with the CFTC/NFA in any capacity or is listed as a principal of a current CFTC registrant. The CFTC's regulations contain certain exemptions from the registration requirement for associated persons.⁸

Proficiency Requirements for Associated Persons. An individual seeking to register as an associated person of a CPO must satisfy the NFA's proficiency requirements. Generally speaking, an individual must have passed the National Commodity Futures Examination, also known as the Series 3 Exam, within the two years preceding his application. To take the Series 3 Exam, an individual must complete the online testing

⁴ Technically speaking, “principal” is not a separate class of persons required to register with the NFA. Nonetheless, people falling within that definition are subject to certain NFA requirements.

⁵ The Form 8-R template is available at <http://www.nfa.futures.org/NFA-registration/templates-and-forms/8rFormentire.pdf>.

⁶ See CFTC Rule 1.3(aa)(3).

⁷ Unlike “principal” status, “associated person” is a separate class of persons who must register with the CFTC.

⁸ See CFTC Rule 3.12(h).

application form, known as Form U10, that is available on the FINRA website.⁹ FINRA typically informs the NFA whether an individual has passed the Series 3 Exam.

The NFA has indicated that an individual may not be required to take the Series 3 Exam if he has passed the examination that he intends to use to satisfy the proficiency requirements either:

- Within two years of the date the application is filed; or
- More than two years prior to the filing date and, since that date, there has not been a period of two consecutive years during which the person was not registered as an associated person (or floor broker) or was not an approved principal of a registered firm.

A person is not required to register as an associated person if he is currently registered as a floor broker.¹⁰

Substitute Examinations and Waivers. The NFA has indicated that, subject to certain conditions, a person may rely on passing an exam other than the Series 3 Exam to satisfy the proficiency requirements (*e.g.*, the Series 31 Futures Managed Funds Examination or the Series 32 Limited Futures Examination).

The NFA may also determine, upon request pursuant to Registration Rule 402, to waive the examination requirement for certain individuals associated with a CPO. The NFA's Director of Compliance may waive the examination requirement in either of the following two cases:

- The CPO or the commodity pool is subject to regulation by a federal or state regulator (*e.g.*, the SEC, federal bank regulators, or state insurance agencies) or the pool is privately offered pursuant to an exemption from the registration under the Securities Act of 1933 (the "1933 Act") and the CPO limits its activities for which registration is required to operating a commodity pool that: (a) engages principally in securities transactions; (b) commits only a small percentage of its assets as initial margin deposits and premiums for futures and options on futures; and (c) uses futures transactions and options on futures only for hedging or risk management purposes.
- The individual requesting the waiver is a general partner of a CPO or of a commodity pool that is primarily involved with securities investments; there is at least one registered general partner of the CPO or pool who has taken and passed the Series 3 examination; and the individual requesting the waiver is not involved in soliciting or accepting pool participations, trading futures or options on futures, handling client funds, supervising any of the above

⁹ See <http://www.finra.org/Industry/Compliance/Registration/QualificationsExams/RegisteredReps/P121907>.

¹⁰ A "floor broker" is an individual who purchases or sells any futures contracts or options on futures on any contract market for any other person.

activities, or engaging in any other activity that is integral to the operation of the fund as a pool.

The individual or firm requesting a waiver must provide a written description of the facts that form the basis for qualifying the individual for the waiver.¹¹

In addition, an individual is not required to take an examination if he is registered with FINRA as a general securities representative of his sponsor and limits his futures activities on behalf of the sponsor to referring clients to the sponsor's associated persons. In addition, the referrals must be solely incidental to the individual's business as a general securities representative.

The NFA's website contains additional information regarding these examinations and the possibility of exam waivers.¹²

IV. Annual Filing Requirements with the NFA

CPOs are required to provide an Annual Registration Update regarding their own registration and the registrations/filings with respect to their associated persons and principals. In addition to completing the Annual Registration Update, a registered CPO must complete an Annual Questionnaire. A registered CPO must also pay annual NFA membership dues of \$750.

CPOs are required to complete the Annual Registration Update and the Annual Questionnaire in the ORS. The NFA typically sends a registered CPO a letter or email (for firms that have signed up for electronic notices) reminding the firm of its obligation to complete these steps.¹³

V. Key Compliance Requirements for CPOs under Part 4 of the CFTC's Regulations

Disclosure Documents. CFTC Rule 4.21 requires a registered CPO to deliver a Disclosure Document to a prospective fund investor no later than the time that the CPO delivers a subscription agreement to that prospective investor. CFTC Rules 4.24 and 4.25 specify the particular requirements for the content of Disclosure Documents. At a high level, those requirements include:

- Prominent and specifically worded cautionary statements and risk disclosure statements, some of which vary based on the types of commodity instruments traded by a fund;
- A table of contents and identifying information for the CPO and the fund;
- The break-even point per unit of initial investment in the fund;

¹¹ See NFA Interpretive Notice 9018 – Registration Rule 402: CPOs of Pools Trading Primarily in Securities (Aug. 1, 1992) (as amended Dec. 10, 2007).

¹² See <http://www.nfa.futures.org/NFA-registration/proficiency-requirements.HTML>.

¹³ For further information regarding these matters, see <http://www.nfa.futures.org/NFA-registration/registration-advisories/advisory-08-13-07.HTML>.

- Identities of (i) the principals of the CPO and each “major CTA,”¹⁴ (ii) trading managers, and (iii) each “major investee pool”¹⁵ and its CPO;
- Business background information for the CPO, the fund’s trading manager, each major CTA, the CPO of each major investee pool, and the principals of those firms;
- Information about the fund’s investment program and related risk factors;
- Fee, commission, and expense information for the fund;
- Disclosure of actual or potential conflicts of interest (*e.g.*, with the CPO, the trading manager, a major CTA, etc.), related party transactions, and material litigation;
- Disclosure regarding trading for the account of the fund’s CPO, trading manager, CTAs, and the principals of those firms;
- Past performance disclosures;
- If applicable, disclosures specific to “principal-protected pools;”¹⁶
- Disclosure of any restrictions on the transferability of fund interests;
- Discussion of the potential liability of fund investors;
- Discussion of distribution of profits and taxation;
- Minimum and maximum aggregate subscription levels;
- Information regarding beneficial ownership of fund interests by interested persons (*e.g.*, the CPO, the trading manager, major CTA, etc.); and
- Other material information.

If a firm is required by CFTC Rule 4.21 to prepare a Disclosure Document with respect to a pool, the Disclosure Document cannot be used until it is reviewed and accepted by the NFA.¹⁷ Registered CPOs must submit Disclosure Documents for review and acceptance by the NFA through the NFA’s electronic Disclosure Document System. The NFA generally seeks to complete its review of a Disclosure Document

¹⁴ With respect to a pool, a “major commodity trading advisor” is any commodity trading advisor that is allocated or is intended to be allocated at least 10% of the pool’s funds available for commodity interest trading. *See* CFTC Rule 4.10(i).

¹⁵ With respect to a pool, a “major investee pool” is any investee pool that is allocated or intended to be allocated at least 10% of the net asset value of the pool. *See* CFTC Rule 4.10(d)(5).

¹⁶ A “principal-protected pool” is a pool (commonly referred to as a guaranteed pool) that is designed to limit the loss of the initial investment of its participants. *See* CFTC 4.10(d)(3).

¹⁷ As explained below, a registered CPO that is eligible to rely on the “CFTC Lite” regime is exempt from the requirement to prepare a Disclosure Document that includes the disclosures mandated by Rule 4.21. As a result, such a CPO would not be required to submit for NFA review the offering memorandum of a fund for which it can rely on the CFTC Lite regime.

within 14 days of receipt, although the process may take longer due to the complexity of the investment strategy or other features of the pool or offering, whether the review pertains to a new or updated Disclosure Document, the Disclosure Document size, the availability of NFA staff resources, and other factors.

The NFA will generally take less time to review a Disclosure Document if it is eligible for “instant filing” treatment. Under the NFA’s instant filing procedures, the NFA’s review will generally be completed within 3 business days if a previously-accepted Disclosure Document is on file, there have been no material changes to the Disclosure Document, and the member firm requests instant filing treatment.¹⁸

Generally speaking, a Disclosure Document must be updated at least every 9 months if a firm is continuing to use the Document to solicit new investors in the related pool. However, a Disclosure Document must be updated more frequently to reflect material changes in information that must be disclosed.

The NFA has published a Disclosure Document Guide for its member firms, which addresses the required disclosures and the filing and review process in further detail.¹⁹

Account Statements and Annual Reports. CFTC Rule 4.22 requires a registered CPO to prepare and disseminate to fund investors an Account Statement, which must be presented in the form of a Statement of Operations and a Statement of Changes in Net Assets. In most cases, the Account Statement must be disseminated monthly, although CPOs may prepare Account Statements on a quarterly basis for investors in a fund with assets of \$500,000 or less. In any case, the Account Statement must be distributed within 30 days after the end of the reporting period.

In addition, Rule 4.22 requires a registered CPO to prepare and disseminate to fund investors an Annual Report with respect to the funds it operates. A registered CPO must also file Annual Reports and certain key financial balances from the Annual Reports with the NFA. The fund’s financial statements must generally be prepared in accordance with U.S. GAAP, although they may be prepared under IFRS in specified cases.²⁰ The financial statements must also be audited by an independent public accountant. A registered CPO must disseminate and file the Annual Report within 90 days after the end of the fund’s fiscal year.

Account Statements and Annual Reports must contain an oath or affirmation as to their accuracy and completeness, which are provided on the basis of the best knowledge and belief of the individual making the oath or affirmation.

¹⁸ The NFA’s procedures for instant filing treatment are described at <http://www.cftc.gov/tm/tminstant.htm>.

¹⁹ A copy of the Disclosure Document Guide is available at <http://www.nfa.futures.org/NFA-compliance/publication-library/disclosure-document-guide.pdf>.

²⁰ A fund’s financial statements may be prepared in accordance with IFRS for this purpose if: (i) the fund is organized under the laws of a non-U.S. jurisdiction; (ii) the annual report includes a condensed schedule of investments (or, if required by the alternate accounting standards, a full schedule of investments); (iii) preparation of the fund’s financial statements under IFRS is not inconsistent with any representations in its offering memorandum or other operative document made available to fund investors; and (iv) special allocations of ownership equity will be reported as specified in CFTC Rule 4.22(e)(2). A CPO would be required to file a notice with the NFA claiming eligibility for relief from the requirement to prepare annual report financial statements in accordance with U.S. GAAP. See CFTC Rule 4.22(d)(2).

The specific details regarding the information to be provided in Account Statements and the Annual Reports are further described in Rule 4.22.

Recordkeeping. CFTC Rule 4.23 imposes recordkeeping requirements on registered CPOs, both with respect to its funds and the CPO itself. In particular, with respect to its funds, Rule 4.23(a) requires a registered CPO to maintain:

- Itemized daily records of the fund’s commodity interest transactions;
- Original journal entries or equivalent records showing all receipts and disbursements;
- Acknowledgements from fund investors of receipt of disclosure documents under CFTC Rule 4.21;
- A subsidiary ledger or equivalent record for each fund investor containing identifying information and other information concerning securities and other property that the fund received from or distributed to the investor;
- Adjusting entries and any other equivalent records forming the basis of entries in any ledger;
- A general ledger or equivalent record detailing all asset, liability, capital, income, and expense accounts;
- Trade confirmations, purchase and sale statements, and monthly statements received from futures brokers and retail foreign exchange dealers;
- Cancelled checks, bank statements, journals, ledgers, invoices, computer generated records, and all other records, data, and memoranda prepared or received in connection with operating the fund;
- Originals or copies of written reports, communications, and advertising (including written transcriptions of standardized oral presentations and mass media presentations) distributed to existing or prospective investors, as well as any such materials the CPO received from any CTA;
- A statement of financial condition for the fund as of the close of each month (if the fund had net assets of less than \$500,000, the report would be quarterly);
- A statement of income (loss) for the fund for a specified period; and
- Manually signed copies of Account Statements and Annual Reports, and records of the key financial balances submitted to the NFA for each Annual Report.

As to the CPO itself, Rule 4.23(b) requires a registered CPO to keep itemized daily records of each commodity interest transaction by the CPO and its principals, as well as confirmations, purchase and sale statements, and monthly statements furnished by

futures brokers and retail foreign exchange dealers to the CPO or to its principals. The Rule also requires a registered CPO to keep books and records of transactions in all other activities in which the CPO engages (*e.g.*, cancelled checks, bank statements, journals, ledgers, invoices, computer generated records, etc.).

Rule 4.7 – Relief Available under the “CFTC Lite” Regime. A registered CPO may be able to rely on the “CFTC Lite” regime under Rule 4.7, which substantially reduces the disclosure, recordkeeping, and reporting requirements discussed above. The CFTC Lite regime is available with respect to a fund in which each investor is a “qualified eligible person” and the offering of interests therein is exempt from registration under the 1933 Act. The definition of “qualified eligible person” is rather lengthy, but notably includes “qualified purchasers” and “knowledgeable employees” as those concepts are defined for purposes of the Investment Company Act of 1940 (the “1940 Act”).²¹ Accordingly, the CFTC Lite regime may be available to sponsors of funds that rely on the Section 3(c)(7) exception to the “investment company” definition contained in the 1940 Act.²² The “qualified eligible person” definition also includes the term “non-United States person.”²³ A registered CPO would need to file a notice of exemption with the NFA in connection with relying on the CFTC Lite regime.

Alternative Relief for Certain Non-U.S. Funds. Firms registered as CPOs may also be able to avail themselves of other relief from disclosure, recordkeeping, and reporting requirements.²⁴

In order to rely on this relief, a firm registered as a CPO must satisfy the following criteria:

- Each pool the CPO operates remains organized and operated outside of the United States;
- Each pool will not hold meetings or conduct administrative activities within the United States;
- No shareholder of or other investor in a pool is or will be a U.S. person;

²¹ Generally speaking, a “qualified purchaser” is an individual or family-owned company that owns at least \$5 million in investments or institutional purchaser or other company that in the aggregate owns and invests at least \$25 million in investments. See Section 2(a)(51) of the 1940 Act. A “knowledgeable employee” is generally considered to be any individual closely involved in the management of the fund or similar operations, but excludes an employee performing solely clerical, secretarial, or administrative functions. See Rule 3c-5 under the 1940 Act.

²² It is possible that an “accredited investor” – as that term is defined for purposes of Regulation D under the 1933 Act – could count as a “qualified eligible person” for purposes of Rule 4.7. However, accredited investors would have to satisfy the portfolio requirement specified in the Rule (*i.e.*, ownership of securities or other investments with an aggregate market value of at least \$2 million, at least \$200,000 in initial margin and option premiums on deposit with a futures commission merchant, or a combination of investments and margin/premium satisfying the requirements of the Rule).

²³ In general, a “non-United States person” is a natural person who is not a resident of the United States or a partnership, corporation or other business entity, organized under the laws of a non-U.S. jurisdiction and which has its principal place of business in a non-U.S. jurisdiction. See CFTC Rule 4.7.

²⁴ See CFTC Release No. 18-96, available at <http://www.cftc.gov/tm/advisory18-96.htm>.

- Each pool will not receive, hold, or invest any capital directly or indirectly contributed from sources within the United States; and
- The CPO, the pool, and any person affiliated therewith will not undertake any marketing activity for the purpose, or that could reasonably be expected to have the effect, of soliciting participation from U.S. persons.

A CPO must notify the CFTC and the NFA that it is claiming this relief.

Rule 4.12 – Reduced Reporting Obligations for Funds. A registered CPO engaged primarily in securities transactions but that uses commodity futures only to a limited extent may rely on Rule 4.12 with respect to a fund in order to omit information that Rule 4.21 would otherwise require to appear in the fund’s Disclosure Document. In addition, the firm would be able to distribute Account Statements to the fund’s investors quarterly rather than monthly. Rule 4.12 also relaxes certain other reporting obligations.²⁵

In order for a CPO to be eligible to rely on Rule 4.12, it must satisfy the following conditions:

- Interests in the fund must be offered pursuant to an effective 1933 Act registration statement or an exemption from 1933 Act registration;
- The fund must engage generally and routinely in the buying and selling of securities and securities-derived instruments;
- The fund must not enter into transactions in commodity interests for which the aggregate initial margin and premiums exceed 10% of the fair market value of the fund’s assets, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into; and
- The commodity interests held by the fund must be traded in a manner that is “solely incidental” to its securities trading activities.

In addition, a CPO relying on Rule 4.12 would be required to inform existing and prospective investors in writing that the pool will comply with the 10% and “solely incidental” limits described above before the date on which the fund begins trading commodity interests.

A CPO seeking to rely on Rule 4.12 must file a claim of exemption with the NFA that makes certain representations as to how the CPO will operate each fund for which the exemption is sought.

Reporting on Form CPO-PQR. CFTC Rule 4.27 requires registered CPOs to file information on new Form CPO-PQR. This Form mirrors the reporting that SEC-registered investment advisers must make on Form PF with respect to their private fund clients. Form CPO-PQR is divided into three Schedules (A, B, and C), which reflect a tiered

system of disclosure based on the size of the firm and, in some respects, the pools it operates:

- Schedule A requests basic information about a CPO, its assets under management, the pools managed by the CPO, certain service providers to those pools, monthly rates of return, and subscription and redemption activity. Each registered CPO must file Schedule A, regardless of the amount of its assets under management.
- Schedule B requests detailed information about commodity pools managed by “mid-sized CPOs”²⁶ and “large CPOs.”²⁷ Generally speaking, Schedule B requires those CPOs to report information about pool strategies, borrowings and types of creditors, counterparty credit exposure, pool trading and clearance mechanisms, aggregate derivatives positions, and pool investments.
- Schedule C requests additional detailed pool information from large CPOs. Schedule C requires those CPOs to provide a geographic breakdown of pool investments and the turnover rate of aggregate pool portfolios. In addition, with respect to “large pools,”²⁸ large CPOs must report counterparty credit exposure, risk metrics, borrowing information, derivative positions and posted collateral, financing liquidity, and investor information.

Smaller CPOs must file Schedule A annually, mid-sized CPOs must file Schedules A and B annually, and large CPOs must file Schedules A, B, and C quarterly. Smaller CPOs must file Schedule A, and mid-sized CPOs must file Schedules A and B, within 90 days of the end of each calendar year. Large CPOs must file Schedules A, B, and C within 60 days of the end of each calendar quarter.

The CFTC has sought to avoid mandating duplicate reporting by CPOs that are also registered as investment advisers with the SEC. Accordingly, the CFTC has explained that, under Rule 4.27, a dual-registered CPO will be permitted to satisfy the requirement to report information on Schedules B and C of Form CPO-PQR by filing Form PF with the SEC.

The NFA requires separate reporting by CPOs and has recently proposed amendments that would harmonize its reporting requirements with those of the CFTC.²⁹

²⁶ According to the instructions for Form CPO-PQR, a “mid-sized CPO” is any CPO that had at least \$150 million in aggregated pool assets under management as of the close of business on any day during the “reporting period.” For a mid-sized CPO, the “reporting period” is the calendar year end.

²⁷ The instructions for Form CPO-PQR provide that a “large CPO” is any CPO that had at least \$1.5 billion in aggregated pool assets under management as of the close of business on any day during the reporting period. For a large CPO, the “reporting period” is any individual calendar quarter ending March 31, June 30, September 30, or December 31.

²⁸ The Form CPO-PQR instructions define “large pool” as any pool with a net asset value (individually or in combination with any “parallel pool structure”) of at least \$500 million as of the close of business on any day during the reporting period. A “parallel pool structure” is any structure in which one or more pools pursues substantially the same investment objective and strategy and invests side-by-side in substantially the same assets as another pool.

²⁹ See NFA Compliance Rule 2-46; letter of June 5, 2012 from Thomas W. Sexton, NFA, to David A. Stawick, CFTC.

Implementation Timeline for Form CPO-PQR Reporting. CPOs with at least \$5 billion in assets under management as of June 30, 2012 must comply with the reporting requirements by September 15, 2012. In practice, this means each of these CPOs must file its first Form CPO-PQR within 60 days after September 30, 2012. All other CPOs must comply with their reporting requirements by December 15, 2012. In practical terms, each of these CPOs must file its first Form CPO-PQR based on information as of December 31, 2012. As noted above, smaller and mid-sized CPOs must file Form CPO-PQR within 90 days of the end of each calendar year. Large CPOs falling below the \$5 billion threshold must file Form CPO-PQR within 60 days after December 31, 2012; the information reported would be on a quarterly basis.

VI. Annual Compliance Self-Examination

CPOs are required to review their operations each year in light of the topics covered in the NFA's then-current Self-Examination Questionnaire.³⁰ The Questionnaire includes points that are applicable to all NFA member firms and a supplement that contains questions specific to CPOs. The Questionnaire also includes appendices that address specific compliance topics (*i.e.*, anti-money laundering, business continuity and disaster recovery, ethics training, and privacy). In essence, the Questionnaire requires a firm to assess its compliance with applicable requirements under both the CEA and the NFA's own rules. An appropriate representative of a CPO must sign the Questionnaire and attest that, in light of the matters covered by the Questionnaire, the firm's current procedures are adequate to meet its supervisory responsibilities.³¹ Copies of these signed Questionnaires must be kept as part of a firm's records and, for the first two years, the copies must be kept in an easily accessible place. Member firms are required to provide their completed Questionnaires to the NFA for inspection upon request.

³⁰ See NFA Compliance Rule 2-9; NFA Interpretive Notice 9020 (rev. Apr. 8, 2011).

³¹ For a copy of the current Self-Examination Questionnaire and for other related information, see <http://www.nfa.futures.org/NFA-compliance/publication-library/self-exam-questionnaire.HTML>.

PART B

COMMODITY TRADING ADVISORS AND THEIR PERSONNEL

I. Background Matters

“Commodity Trading Advisor” Definition. The term “commodity trading advisor” includes any person who, for compensation or profit, engages in the business of advising others, either directly or through publications, writings or electronic media, as to the value of or the advisability of trading in commodity interests, including: any future, security futures product, or swap; authorized commodity option or leverage transaction; or retail forex or commodity transactions as further defined in the CEA. The term also includes any person who, for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the foregoing. The definition also includes any entity or person that is otherwise registered with the CFTC as a CTA for whatever reason.

The definition of “commodity trading advisor” expressly excludes the following persons, provided that the rendering of commodity trading advice is “solely incidental” to the conduct of their business or profession: (i) any bank or trust company or any person acting as an employee thereof; (ii) any news reporter, news columnist, or news editor of the print or electronic media, or any lawyer, accountant, or teacher; (iii) any floor broker or futures broker, (iv) the publisher or producer of any print or electronic data of general and regular dissemination, including its employees; (v) the named fiduciary, or trustee, of any defined benefit plan which is subject to ERISA or any fiduciary whose sole business is to advise that plan; (vi) any contract market or derivatives transaction execution facility, and (vii) such other persons not within the intent of this definition as the CFTC may specify by rule.

CTA Registration Requirements. Absent an available exemption, a firm that falls within the CTA definition must register as a CTA with the CFTC. The registration process is administered by the NFA. Certain firm personnel will fall within the definitions of “principal” and “associated person” and will also be subject to registration or filing requirements.

Certain exemptions from CTA registration are discussed in Part C of this outline.

II. Registration Requirements for Firms

General Considerations. A firm files for registration as a CTA by using the ORS. The ORS may be accessed at www.nfa.futures.org. In general, the registration process takes 3-4 months. Firms should plan for registration to take somewhat longer at least throughout the balance of 2012, however, because the NFA will likely face resource constraints in dealing with a substantial uptick in new registrations owing to the CFTC’s recent decision to rescind Rule 4.13(a)(4), a commonly-used exemption from CTA registration requirements.

Registration Requirements for Firms. In order to register with the NFA, a firm must take the following steps:

- Complete the online version of Form 7-R, the Firm Application;³²
- Submit a non-refundable application fee of \$200; and
- Pay NFA-mandated CTA membership dues of \$750. (CTAs, like CPOs, are required to be members of NFA and so, similarly, if someone is denied membership or later disciplined by the NFA by being barred from membership, that person cannot act as a CTA.)

As part of the registration process, CTAs are required to design and implement a program for complying with the rules and regulations of the CFTC and the NFA. Key topics that must be covered by a firm's compliance program include:

- Ethics training for employees;
- Annual compliance reviews;
- Inspections of branch offices;
- Registration of new employees; and
- Disaster recovery planning.

In addition, firms typically include in their compliance manuals procedures for complying with other CFTC/NFA requirements, including notably the disclosure, reporting, and recordkeeping requirements relating to commodity pools found in Part 4 of the CFTC's regulations. We discuss those requirements below. Firms that are registered with the SEC as investment advisers may be able to incorporate these separate procedures in their existing manuals.

III. Registration and Filing Requirements for Principals and Associated Persons

Principal Status. NFA Registration Rule 101 defines the term "principal" in relevant part as:

- (1) an individual who is:
 - (A) a proprietor of a CTA that is a sole proprietorship;
 - (B) a general partner of a CTA organized as a partnership;
 - (C) a director, president, chief executive officer, chief operating officer, or chief financial officer of a corporation, or a person in charge of a business unit, division or function of a corporation the activities of

³² The Form 7-R template is available at <http://www.nfa.futures.org/NFA-registration/templates-and-forms/form7-r.HTML>.

which would fall within the regulatory jurisdiction of the CFTC (*e.g.*, its activities would qualify it as a CTA); or

(D) a director, the president, chief executive officer, chief operating officer, chief financial officer, manager, or managing member of a limited liability company or limited liability partnership or those members of a limited liability company or limited liability partnership vested with the management authority for the entity, and any person in charge of a principal business unit, division or function subject to regulation by the CFTC as a CTA; or

(2) an individual who directly or indirectly, through agreement, holding companies, nominees, trusts or otherwise:

(A) is the owner of 10% or more of the outstanding shares of any class of a CTA's stock;

(B) is entitled to vote 10% or more of any class of a CTA's voting securities;

(C) has the power to sell or direct the sale of 10% or more of any class of a CTA's voting securities;

(D) has contributed 10% or more of a CTA's capital;

(E) is entitled to receive 10% or more of a CTA's net profits; or

(F) has the power to exercise a controlling influence over a CTA's activities that are subject to regulation by the CFTC.³³

An individual's status as a principal is determined by his ability to control the entity's business activities, his formal title or position with the entity, or his financial or ownership interest in the entity. An individual who, through his conduct or activity, directly or indirectly controls an entity is a principal, regardless of his formal title or financial interest in the entity. An individual who holds a specific position or has a specific title is also a principal, regardless of his ability to control the entity's business.

The definition of "principal" also includes certain entities. Further information on principal status, including examples of personnel and entities who may be required to register as principals, is available in the online NFA rulebook and on the NFA website.³⁴

Principal Filing Requirements. Firm personnel who fall within the definition of "principal" must complete the following steps in connection with their firm registering as a CTA:³⁵

³³ See also CFTC Rule 3.1(a).

³⁴ For the definition of principal, see <http://www.nfa.futures.org/nfamanual/NFAManual.aspx?RuleID=RULE101&Section=8>. For further background on principal status, see <http://www.nfa.futures.org/NFA-registration/principal/index.HTML>.

- Complete online Form 8-R, the Individual Application;³⁶
- Submit fingerprint cards;
- Complete the verification of the person's Form 8-R; and
- Pay a non-refundable application fee of \$85.00.

A person need not pay the application fee if he is registered with the CFTC/NFA in any capacity or is listed as a principal of a current CFTC registrant.

Associated Person Status. An individual will be considered an “associated person” of a CTA if that person is associated with the CTA in any capacity as a partner, officer, employee, consultant, or agent (or who has a similar status or performs similar functions), and is involved in the solicitation of a client's or prospective client's discretionary account. In addition, a person will be considered an associated person if he supervises any person engaged in those solicitations.³⁷ In this regard, the NFA has indicated that the “associated person” designation generally applies to any person in the “supervisory chain-of-command” and not just the direct supervisor of a person engaged in solicitation.

Associated Person Registration Process. Firm personnel who fall within the definition of “associated person” must register with the NFA by completing the following steps:³⁸

- Complete online Form 8-R, the Individual Application;
- Submit fingerprint cards;
- Satisfy the NFA's Proficiency Requirements (described below);
- Complete the verification of the person's Form 8-R; and
- Pay a non-refundable application fee of \$85.00.

A person need not pay the application fee if he is registered with the CFTC/NFA in any capacity or is listed as a principal of a current CFTC registrant. The CFTC's regulations contain certain exemptions from the registration requirement for associated persons.³⁹

Proficiency Requirements for Associated Persons. An individual seeking to register as an associated person of a CTA must satisfy the NFA's proficiency requirements. Generally speaking, an individual must have passed the National Commodity Futures Examination, also known as the Series 3 Exam, within the two years preceding his application. To take the Series 3 Exam, an individual must complete the online testing

³⁵ Technically speaking, “principal” is not a separate class of persons required to register with the NFA. Nonetheless, people falling within that definition are subject to certain NFA requirements.

³⁶ The Form 8-R template is available at <http://www.nfa.futures.org/NFA-registration/templates-and-forms/8rFormentire.pdf>.

³⁷ See CFTC Rule 1.3(aa)(4).

³⁸ Unlike “principal” status, “associated person” is a separate class of persons who must register with the CFTC.

³⁹ See CFTC Rule 3.12(h).

application form, known as Form U10, that is available on the FINRA website.⁴⁰ FINRA typically informs the NFA whether an individual has passed the Series 3 Exam.

The NFA has indicated that an individual may not be required to take the Series 3 Exam if he has passed the examination that he intends to use to satisfy the proficiency requirements either:

- Within two years of the date the application is filed; or
- More than two years prior to the filing date and, since that date, there has not been a period of two consecutive years during which the person was not registered as an associated person (or floor broker) or was not an approved principal of a registered firm.

It should also be noted that a person is not required to register as an associated person if he is currently registered as a floor broker.⁴¹

Substitute Examinations and Waivers. The NFA has indicated that, subject to certain conditions, a person may rely on passing an exam other than the Series 3 Exam to satisfy the proficiency requirements (*e.g.*, the Series 31 Futures Managed Funds Examination or the Series 32 Limited Futures Examination).

The NFA may also determine, upon request pursuant to Registration Rule 402, to waive the examination requirement for certain individuals associated with a CTA who are required to register solely because their securities advisory services include advice on the use of futures and options for risk management purposes. The NFA's Director of Compliance may waive the examination requirement if:

- the CTA is subject to regulation by a federal or state regulator;
- for each client for whom the CTA provides futures trading advice, that advice is incidental to the securities advisory services the CTA provides to the client; and
- the futures trading advice offered by the CTA is for hedging or risk management purposes.

The individual or firm requesting a waiver must provide a written description of the facts that form the basis for qualifying the individual for the waiver.⁴²

In addition, an individual is not required to take an examination if he is registered with FINRA as a general securities representative of his sponsor and limits his futures activities on behalf of the sponsor to referring clients to the sponsor's associated persons. In addition, the referrals must be solely incidental to the individual's business as a general securities representative.

⁴⁰ See <http://www.finra.org/Industry/Compliance/Registration/QualificationsExams/RegisteredReps/P121907>.

⁴¹ A "floor broker" is an individual who purchases or sells any futures contracts or options on futures on any contract market for any other person.

⁴² See NFA Interpretive Notice 9022 – Registration Rule 402: CTAs Trading Primarily in Securities (Sept. 21, 1993) (as revised Dec. 10, 2007).

The NFA's website contains additional information regarding these examinations and the possibility of exam waivers.⁴³

IV. Annual Filing Requirements with the NFA

CTAs are required to provide an Annual Registration Update regarding their own registration and the registrations/filings with respect to their associated persons and principals. In addition to completing the Annual Registration Update, a registered CTA must complete an Annual Questionnaire. A registered CTA must also pay annual NFA membership dues of \$750.

CTAs are required to complete the Annual Registration Update and the Annual Questionnaire in the ORS. We understand that the NFA typically sends a registered CTA a letter or email (for firms that have signed up for electronic notices) reminding the firm of its obligation to complete these steps.⁴⁴

V. Key Compliance Requirements for CTAs under Part 4 of the CFTC's Regulations

Disclosure Documents. CFTC Rule 4.31 requires a registered CTA to deliver a Disclosure Document to a prospective client no later than the time that the CTA delivers to the prospective client an advisory agreement to direct or guide the client's account. CFTC Rules 4.34 and 4.35 specify the particular requirements for the content of Disclosure Documents. At a high level, those requirements include:

- Prominent and specifically worded cautionary statements and risk disclosure statements, some of which vary based on the trading program and investments pursued by the CTA;
- A table of contents and identifying information for the CTA;
- Identities of the CTA's principals, the relevant futures broker and/or retail foreign exchange dealer, and the introducing broker through which the client may introduce its account;
- Business background information for the CTA and its principals;
- Information about the trading program and related risk factors;
- Fees the CTA will charge the client;
- Disclosure of actual or potential conflicts of interest (with the CTA, any relevant futures broker and/or retail foreign exchange dealer, any introducing agent, and any principal of the foregoing) and material litigation;
- Disclosure regarding trading for the account of the CTA and its principals;

⁴³ See <http://www.nfa.futures.org/NFA-registration/proficiency-requirements.HTML>.

⁴⁴ For further information regarding these matters, see <http://www.nfa.futures.org/NFA-registration/registration-advisories/advisory-08-13-07.HTML>.

- Past performance disclosures; and
- Other material information.

If a firm is required by CFTC Rule 4.31 to prepare a Disclosure Document, the Disclosure Document cannot be used until it is reviewed and accepted by the NFA.⁴⁵

Registered CTAs must submit Disclosure Documents for review and acceptance by the NFA through the NFA's electronic Disclosure Document System. The NFA generally seeks to complete its review of a Disclosure Document within 14 days of receipt, although the process may take longer due to the complexity of the investment program, whether the review pertains to a new or updated Disclosure Document, the Disclosure Document size, the availability of NFA staff resources, and other factors.

The NFA will generally take less time to review a Disclosure Document if it is eligible for "instant filing" treatment. Under the NFA's instant filing procedures, the NFA's review will generally be completed within 3 business days if a previously-accepted Disclosure Document is on file, there have been no material changes to the Disclosure Document, and the member firm requests instant filing treatment.⁴⁶

Generally speaking, a Disclosure Document must be updated at least every 9 months if a firm is continuing to use the Document to solicit new clients. However, a Disclosure Document must be updated more frequently to reflect material changes in information that must be disclosed.

The NFA has published a Disclosure Document Guide for its member firms, which addresses the required disclosures and the filing and review process in further detail.⁴⁷

Recordkeeping. CFTC Rule 4.33 imposes recordkeeping requirements on registered CTAs, both with respect to the clients and subscribers of the CTA and the CTA itself. In particular, with respect to its clients and subscribers, Rule 4.33(a) requires a registered CTA to maintain:

- The name and address of each client and each subscriber;
- Acknowledgements from clients of receipt of disclosure documents under CFTC Rule 4.31;
- All powers of attorney and other documents authorizing the CTA to direct the commodity interest account of each client and each subscriber;
- All other written agreements entered into by the CTA with each client and each subscriber;

⁴⁵ As explained below, a registered CTA that is eligible to rely on the "CFTC Lite" regime is exempt from the requirement to prepare a Disclosure Document that includes the disclosures mandated by Rule 4.31. As a result, such a CTA would not be required to submit for NFA review the offering memorandum of a fund for which it can rely on the CFTC Lite regime.

⁴⁶ The NFA's procedures for instant filing treatment are described at <http://www.cftc.gov/tm/tminstant.htm>.

⁴⁷ A copy of the Disclosure Document Guide is available at <http://www.nfa.futures.org/NFA-compliance/publication-library/disclosure-document-guide.pdf>.

- A list or record of all commodity interest accounts of clients directed by the CTA and of all transactions effected for such accounts;
- Confirmations of commodity interest transactions, purchase and sale statements, and monthly statements received from futures brokers and retail foreign exchange dealers; and
- Reports, letters, circulars, memoranda, publications, writings, advertisements and other literature or advice distributed or caused to be distributed by the CTA to existing and prospective clients and subscribers.

As to the CTA itself, Rule 4.33(b) requires a registered CTA to keep itemized daily records of each commodity interest transaction by the CTA, as well as confirmations, purchase and sale statements, and monthly statements furnished by futures brokers and retail foreign exchange dealers to the CTA or to its principals. The Rule also requires a registered CTA to keep books and records of transactions in all other activities in which the CTA and its principals engage.

Rule 4.7 – Relief Available under the “CFTC Lite” Regime. A registered CTA may be able to rely on the “CFTC Lite” regime under Rule 4.7, which substantially reduces the disclosure and recordkeeping requirements discussed above. The CFTC Lite Regime is available with respect to the commodity interest accounts of qualified eligible persons who have given due consent to their account being an exempt account under Rule 4.7. The definition of “qualified eligible person” is rather lengthy, but notably includes “qualified purchasers” and “knowledgeable employees” as those concepts are defined for purposes of the 1940 Act.⁴⁸ The “qualified eligible person” definition also includes the term “non-United States person.”⁴⁹ A registered CTA would need to file a notice of exemption with the NFA in connection with relying on the CFTC Lite regime.

Reporting on Form CTA-PR. CFTC Rule 4.27 requires registered CTAs to file information on new Form CTA-PR. Form CTA-PR requires a CTA to report basic identifying information, the total assets and total pool assets directed by the CTA, the names of the pools the CTA advises, and the name of the CPO that is reporting information for each identified pool. CTAs are required to complete Form CTA-PR annually and to submit the Form to the NFA, even if the CTA is also registered with the SEC and reporting on Form PF. A CTA must file its Form CTA-PR within 45 days of the end of each calendar year. In addition, Rule 4.27(d) provides that any Form PF a CTA files with the SEC will be deemed to have been filed with the CFTC for enforcement purposes.

⁴⁸ Generally speaking, a “qualified purchaser” is an individual or family-owned company that owns at least \$5 million in investments or institutional purchaser or other company that in the aggregate owns and invests at least \$25 million in investments. See Section 2(a)(51) of the 1940 Act. A “knowledgeable employee” is generally considered to be any individual closely involved in the management of the fund or similar operations, but excludes an employee performing solely clerical, secretarial, or administrative functions. See Rule 3c-5 under the 1940 Act.

⁴⁹ In general, a “non-United States person” is a natural person who is not a resident of the United States or a partnership, corporation or other business entity, organized under the laws of a non-U.S. jurisdiction and which has its principal place of business in a non-U.S. jurisdiction. See CFTC Rule 4.7.

A registered CTA must file its first Form CTA-PR based on information as of December 31, 2012.

The NFA has proposed imposing separate reporting requirements for CTAs that will overlap in many respects with the reporting required by the CFTC on Form CTA-PR.⁵⁰

VI. Annual Compliance Self-Examination

CTAs are required to review their operations each year in light of the topics covered in the NFA's then-current Self-Examination Questionnaire.⁵¹ The Questionnaire includes points that are applicable to all NFA member firms and a supplement that contains questions specific to CTAs. The Questionnaire also includes appendices that address specific compliance topics (*i.e.*, anti-money laundering, business continuity and disaster recovery, ethics training, and privacy). In essence, the Questionnaire requires a firm to assess its compliance with applicable requirements under both the CEA and the NFA's own rules. An appropriate representative of a CTA must sign the Questionnaire and attest that, in light of the matters covered by the Questionnaire, the firm's current procedures are adequate to meet its supervisory responsibilities.⁵² Copies of these signed Questionnaires must be kept as part of a firm's records and, for the first two years, the copies must be kept in an easily accessible place. Member firms are required to provide their completed Questionnaires to the NFA for inspection upon request.

⁵⁰ See letter of June 5, 2012 from Thomas W. Sexton, NFA, to David A. Stawick, CFTC (proposing amendments to NFA Compliance Rule 2-46).

⁵¹ See NFA Compliance Rule 2-9; NFA Interpretive Notice 9020 (rev. Apr. 8, 2011).

⁵² For a copy of the Self-Examination Questionnaire and for other related information, see <http://www.nfa.futures.org/NFA-compliance/publication-library/self-exam-questionnaire.HTML>.

PART C

KEY EXEMPTIONS FROM CPO AND CTA REGISTRATION

This Part briefly describes certain key exemptions from CPO and CTA registration that may be available to firms that sponsor or advise private funds. Whether a particular firm may rely on a specific exemption will largely depend upon the nature and scope of the firm's activities as they pertain to commodity interest trading for client accounts. Accordingly, firms should not rely upon the following summaries of the various key exemptions as a basis for concluding that they are exempt from CPO or CTA registration.

Part I below identifies the key exemption from CPO registration, and Part II describes key current exemptions from CTA registration. Part III identifies exemptions from both CPO and CTA registration available solely to certain non-U.S. firms.

I. CPO Exemption

Rule 4.13(a)(3) – De Minimis Exemption. Under Rule 4.13(a)(3), a firm is not required to register with the CFTC as a CPO with respect to a privately offered fund if the fund engages in limited trading of commodity interests. Pursuant to the Rule, a fund must satisfy at least one of the following limits:

- **Initial Margin Limit.** The aggregate initial margin, premiums, and required minimum security deposit for retail forex transactions required to establish the fund's positions in commodity interests (determined at the time the most recent position was established) must not exceed 5% of the liquidation value of the fund's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into.⁵³
- **Aggregate Net Notional Value Limit.** The aggregate net notional value of a fund's positions in commodity interests, determined at the time the most recent position was established, must not exceed 100% of the liquidation value of the fund's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into.⁵⁴

⁵³ In the case of an option that is in-the-money at the time of purchase, the in-the-money amount, as defined in Rule 190.01(x) of the CFTC's regulations, may be excluded in computing the 5% limitation.

⁵⁴ "Notional value" is calculated for each futures position by multiplying the number of contracts by the size of the contract in contract units (taking into account any multiplier specified in the contract), then multiplying that number by the current market price per unit; for each option position by multiplying the number of contracts by the size of the contract, adjusted by its delta, in contract units (taking into account any multiplier specified in the contract), and then multiplying that number by the strike price per unit; for each retail forex transaction, by calculating the value in U.S. Dollars of such transaction, at the time the transaction was established, excluding for this purpose the value in U.S. Dollars of offsetting long and short transactions, if any; and for any cleared swap by the value as determined consistent with the terms of Part 45 of the CFTC Rules. Futures contracts with the same underlying commodity across designated contract markets and foreign boards of trade; and swaps cleared on the same designated clearing organization, may be netted where appropriate.

To make use of this exemption, each fund investor must be: (i) an “accredited investor,” as that term is defined in Rule 501(a) of the 1933 Act; (ii) a trust formed by an accredited investor for the benefit of a family member; (iii) a “knowledgeable employee,” as that term is defined in Rule 3c-5 under the 1940 Act; or (iv) a “qualified eligible person” as defined in CFTC Rule 4.7. In addition, in relying on this exemption a firm cannot market the fund as a vehicle for trading in commodity interests.

Notice Filing and Annual Update. A firm relying on this exemption must file a notice of exemption with the NFA and must affirm at the end of each calendar year that it is conducting its activities in accordance with the terms of the exemption. If it cannot do so, the firm must withdraw its claim of exemption.

Application in Funds-of-Funds Context. In 2003, the CFTC published guidance regarding how the Initial Margin Limit and the Net Notional Value Limit would apply in the context of funds-of-funds. Until April 24, 2012, this guidance appeared as Appendix A to the CFTC’s Part 4 regulations. As of that date, however, the CFTC includes Form CPO-PQR as Appendix A to the Part 4 regulations. The CFTC adopted this reporting requirement for CPOs under Rule 4.27 as part of its February 2012 rule amendments. The CFTC did not state in the February rulemaking that it intended to withdraw the guidance, and there is nothing in Form CPO-PQR that would appear to contradict it. In addition, the CFTC determined at that time to retain – rather than repeal, as it had proposed – the Section 4.13(a)(3) exemption to which its guidance relates. In addition, we have heard informally that the CFTC staff is likely to republish the guidance, perhaps in a somewhat revised form.

Firms may wish to work with counsel in ascertaining whether it would be appropriate for them to consider this guidance in seeking to apply Rule 4.13(a)(3) to their funds-of-funds structures.

Retail Forex Transactions. In essence, a “retail forex transaction” is an off-exchange foreign currency transaction in which one party is not an eligible contract participant (an “ECP”). This category of instruments generally includes off-exchange futures and options on foreign currency, as well as other transactions that are offered or entered into on a leveraged or margined basis or financed on a similar basis by the counterparty or a person acting in concert with the counterparty. Retail forex transactions do not include transactions that are effectively actual spot trades – i.e., transactions that either (a) result in actual delivery within two days or (b) create an enforceable obligation to deliver between parties who are capable of making and taking delivery in connection with their line of business.⁵⁵

In relevant part, the CEA defines ECP as a commodity pool with total assets exceeding \$5 million and that is formed and operated by a CFTC-registered firm (e.g., a CPO) or similar foreign person subject to foreign regulation.⁵⁶ The definition also applies a “look-through” requirement, meaning that the pool’s investors must be ECPs.

⁵⁵ See CEA §§ 2(c)(2)(B)-(C); see also CFTC Rule 5.1(m).

⁵⁶ See CEA § 1a(18)(A)(iv).

On May 23, 2012, the CFTC published final rules further clarifying ECP status for funds and other persons.⁵⁷ The rules provide that a fund that is the counterparty to retail forex transactions (a “transaction-level pool”) and that has one or more non-ECP participants is not itself an ECP for purposes of the CEA’s provisions governing retail forex transactions.⁵⁸ But, to determine whether a fund that is a direct investor in a transaction-level pool (an “investor pool”) is an ECP for purposes of the transaction-level pool’s retail forex transactions, there is no requirement to “look through” to that investor pool’s investors. This relief would not be available, however, if the transaction-level pool, any direct or indirect investor pool, or any commodity pool in which the transaction-level pool holds a direct or indirect interest, has been structured in order to permit non-ECPs to participate in retail forex transactions.

The rules also provide that a commodity pool that enters into a retail forex transaction is an ECP with respect thereto, regardless of whether each participant in the pool is an ECP, if all of the following conditions are satisfied:

- the pool is not formed for the purpose of evading regulation under the provisions of the CEA and the CFTC rules, regulations, and orders relating to retail forex transactions;
- the pool has total assets exceeding \$10 million; and
- the pool is formed and operated by a registered CPO or by a CPO who is exempt from registration under Rule 4.13(a)(3).⁵⁹

The CFTC has indicated that, because many pools will have been formed by CPOs exempt from registration under Rule 4.13(a)(4), the “formed by” element of this rule will not be a requirement for pools formed before the end of the 2012. Based on this guidance, it would appear that this relief would be available to private funds with respect to which their general partners or other sponsors have claimed the now-rescinded Rule 4.13(a)(4) exemption and, after December 31, 2012, are registered with the CFTC or exempt from registration under Rule 4.13(a)(3).⁶⁰

These rule changes may raise interpretive issues for firms that engage in foreign currency transactions and that are seeking to evaluate whether they may rely on the Rule 4.13(a)(3) exemption from CPO registration. Firms may wish to work with counsel in assessing these issues.

Note: CFTC Rule 4.13 contains additional exemptions from CPO registration. We expect that those exemptions are unlikely to be useful for the vast majority of firms, and thus do not summarize them here.

⁵⁷ See 77 Fed. Reg. 30596 (May 23, 2012).

⁵⁸ CFTC Rule 1.3(m)(5).

⁵⁹ CFTC Rule 1.3(m)(8).

⁶⁰ See 77 Fed. Reg. at 30659 n.736.

II. CTA Exemptions

CEA Section 4m(1) and CFTC Rule 4.14(a)(10) – 15 or Fewer Clients. Section 4m(1) of the CEA provides that a person need not register as a CTA if, during the course of the preceding 12 months, the person has not furnished commodity trading advice to more than 15 persons. In addition, the person must not hold itself out generally to the public as a CTA.

Rule 4.14(a)(10) provides additional guidance regarding how a person relying on this exemption would count clients toward the 15-client limit. In particular, non-U.S. firms need only count U.S.-resident clients towards the 15-client limit.⁶¹ In addition, the Rule provides that a person shall not be deemed to hold itself out generally to the public for purposes of Section 4m(1) solely because the person participates in a non-public offering of interests in a collective vehicle (*e.g.*, a private offering of securities exempt from registration under the 1933 Act).

We understand that the CFTC tends to take an expansive view of those activities that would constitute “holding oneself out” generally to the public as a CTA.

CEA Section 4m(3) – Certain SEC-Registered Investment Advisers. Section 4m(3) of the CEA provides that a person need not register as a CTA if that person is registered with the SEC as an investment adviser under the Investment Advisers Act of 1940, provided that the person’s business does not consist “primarily” of acting as a CTA and does not act as a CTA to any commodity pool that is engaged primarily in trading commodity interests. For this purpose, the CTA provides that a CTA or a commodity pool shall be considered to be “engaged primarily” in the business of being a CTA or commodity pool if it is or holds itself out to the public as being engaged primarily, or proposes to engage primarily, in the business of advising on commodity interests or investing, reinvesting, owning, holding, or trading in commodity interests, respectively.

CFTC Rule 4.14(a)(8) – Certain SEC- or State-Registered Investment Advisers; Exempt and Excluded Investment Advisers. Rule 4.14(a)(8) provides that an SEC- or state-registered investment adviser, an investment adviser exempt from SEC registration, or an investment adviser excluded from SEC registration need not register as a CTA, provided that:

- The firm’s commodity trading advice is directed solely to, and for the sole use of, one or more:
 - “qualifying entities” for which a notice of eligibility for the Rule 4.5 exclusion has been filed with the NFA;⁶²

⁶¹ Any corporation, general partnership, limited partnership, limited liability company, trust (except as otherwise set forth in the CFTC Rules), and any other legal organization will be counted as one client for purposes of the 15-client limit if such entity receives commodity trading advice based on its investment objectives rather than the individual investment objectives of its shareholders, partners, limited partners, members, or beneficiaries.

⁶² Generally speaking, under Rule 4.5(b) “qualifying entities” include SEC-registered investment companies, insurance company separate accounts, bank custodial accounts and trust accounts, and ERISA pension plans.

- collective investment vehicles excluded from the definition of “commodity pool;”⁶³
 - certain non-U.S. commodity pools;
 - a CPO claiming the exemption from CPO registration under Rule 4.13(a)(3); or
 - a registered CPO that may treat each pool it operates that meets the criteria of Rule 4.13(a)(3) as if it were not so registered;
- The firm provides commodity trading advice “solely incidental” to its business of providing securities or other investment advice to the aforementioned clients;
 - The firm does not otherwise hold itself out as a CTA;
 - The firm files an exemption with the NFA and affirms at the end of each calendar year that it is conducting its activities in accordance with the terms of the exemption (if it cannot do so, the firm must withdraw its claim of exemption); and
 - The firm must make and keep certain books and records prepared in connection with its commodity trading advice.

In addition, a firm relying on Rule 4.14(a)(8) must submit to any special calls the CFTC makes to demonstrate its eligibility for and compliance with the exemption’s other requirements.

Rule 4.14(a)(4) – Registered CPOs. Under CFTC Rule 4.14(a)(4), a firm registered as a CPO need not register as a CTA if the firm’s commodity trading advice is directed solely to, and for the sole use of, the pool or pools for which it is so registered.

Rule 4.14(a)(5) – Exempt CPOs. Under CFTC Rule 4.14(a)(5), a firm exempt from registration as a CPO need not register as a CTA if the firm’s commodity trading advice is directed solely to, and for the sole use of, the pool or pools for which it is so exempt.

III. CPO/CTA Exemptions for Non-U.S. Firms

While non-U.S. firms may rely on the exemptions outlined in Sections I and II above to the extent they meet the conditions of those exemptions, there are additional exemptions available to non-U.S. firms. We discuss key exemptions for non-U.S. firms below.

Rule 30.5 – Exemption for Non-U.S. Firms Effecting Commodity Interest Transactions Solely in Non-U.S. Markets. CFTC Rule 30.5 provides an exemption from CPO and CTA registration for persons that are not located in the U.S. and that only deal

⁶³ Under Rule 4.5(a)(4), these vehicles include, in general terms, certain noncontributory plans, contributory defined benefit plans, governmental plans, employee welfare benefit plans, and church plans.

in, or advise on, futures on or subject to the rules of non-U.S. commodity exchanges or boards of trade. In order to claim this exemption, a non-U.S. firm must file with the NFA a form that includes appointment of the NFA as an agent for service of process in the United States. This filing is made online, and a small filing fee applies.

While this exemption is subject to confirmation by the NFA, we understand that this confirmation is routinely provided for firms that appear to qualify for the exemption. A non-U.S. firm that deals in, or advises on, futures contracts and options on futures contracts on or subject to the rules of U.S. exchanges may not rely on this exemption.

Rule 3.10(c)(3)(i) – Exemption for Non-U.S. Firms Effecting Commodity Interest Transactions in U.S. Markets. CFTC Rule 3.10(c)(3)(i) provides that a non-U.S. person engaged in the activity of a CPO or CTA in connection with any commodity interest transaction made on or subject to the rules of any designated contract market or derivatives transaction execution facility only on behalf of persons located outside the United States, its territories, or possessions is not required to register with the CFTC as such.⁶⁴ In order to rely on this exemption, each such commodity interest transaction must be submitted for clearing through a futures commission merchant registered with the CFTC. (The CFTC has proposed amending this regulation, pursuant to the Dodd-Frank Act, to include within its scope transactions made on a swap execution facility and submitted for clearing.)

Based on prior CFTC no-action guidance from which this exemption evolved, we understand that a firm seeking to rely on the exemption may do so only if no fund investor is a resident or citizen of the United States and if none of the funds or other capital contributed to the fund comes from U.S. sources.⁶⁵

⁶⁴ In general, a designated contract market is a board of trade or exchange that operates under the CFTC's regulatory oversight pursuant to Section 5 of the CEA. A derivatives transaction execution facility is a board of trade that is registered with the CFTC, trades only certain commodities, and generally excludes retail participants.

⁶⁵ See CFTC Staff Letter 76-21 (Aug. 15, 1976); see also, e.g., CFTC Staff Letter 01-62 (June 13, 2001) (noting that, in addition to the absence of U.S. investors and U.S. sources of funds, no affiliates of the commodity pools would market those pools in a way that would solicit participation from U.S. persons or would market the pools from the United States).

PART D

CONTACT INFORMATION

Please feel free to reach out to your regular contacts at the Firm if you have any questions about the matters addressed in this outline. In addition, you are welcome to contact any of the following members of the Firm's CFTC Working Group:

Geoffrey Aronow, Partner

T: + 1 202 373 6277
geoffrey.aronow@bingham.com

Mana Behbin, Counsel

T: +1 202 373 6599
m.behbin@bingham.com

John Holton, Partner

T: +44 20 7661 5336
john.holton@bingham.com

Ken Kopelman, Partner

T: +1 212 705 7278
ken.kopelman@bingham.com

Robert Leonard, Partner

T: +1 212 705 7802
robert.leonard@bingham.com

Michael Mavrides, Partner

T: +1 212 705 7813
michael.mavrides@bingham.com

Joshua Sterling, Partner

T: +1 202 373 6556
joshua.sterling@bingham.com

This outline has been prepared by Joshua Sterling, Mana Behbin and Jason Scoffield, with assistance from Ruoke Liu.