



Commodity Futures Trading Commission

Office of Public Affairs

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Division of Swap Dealer and Intermediary Oversight Responds to Frequently Asked Questions – CPO/CTA: Amendments to Compliance Obligations

Who is the Commodity Pool Operator?

1. Which entity should be required to register as the CPO of the controlled foreign corporation (“CFC”)?

To the extent that the registered investment company’s CPO is making the determination regarding the engagement of Commodity Trading Advisors (“CTAs”) and the allocation of CFC assets, the CPO for the registered investment company should also be the CPO for the CFC. This designation should be assumed to be appropriate unless the registered investment company’s CPO has otherwise delegated its rights and responsibilities consistent with the applicable law and the pool’s organizational documents.

2. If, pursuant to the laws of the jurisdiction in which the commodity pool is organized and the organizational documents of the commodity pool, a general partner, managing member, or board of directors is permitted to delegate its rights and powers to manage to one or more persons, may the general partner, managing member, or board of directors delegate its CPO rights and obligations to another person that is qualified to serve as CPO and is registered as a CPO with the CFTC?

Where the general partner, managing member or board of directors of a commodity pool is legally permitted to delegate its rights and responsibilities with respect to the operation of the commodity pool to one or more persons, the manager may delegate its rights and obligations as CPO to another person, provided that such person is qualified to serve as CPO and is registered as a CPO with the Commission, and subject to that person’s agreement to assume such rights and obligations, particularly with respect to compliance with the Commodity Exchange Act and the Commission’s regulations promulgated thereunder. Consistent with letters previously issued regarding such delegations, the delegating entity must agree to remain jointly and severally liable with respect to any violations of the Commodity Exchange Act.

Wholly Owned Subsidiaries

1. Should the wholly owned trading subsidiary of a commodity pool be deemed and regulated as a “pool” within the meaning of Commission Regulation 4.10(d) where the parent is operated by a registered CPO?

In the preamble to the final rules in Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, the Commission stated its position that wholly owned controlled foreign corporations that are used by registered investment companies as the trading vehicles for their derivatives activities are commodity pools under the terms of the CEA and the Commission’s regulations. The Commission made this determination in part because it does not believe that the interposition of an investee fund between the participants and the trading vehicle alters the fact that the funds being traded by the investor fund are the commingled assets of multiple participants, to be shared with each participant on a pro-rata basis. Staff believes that this reasoning is equally applicable in the context of a wholly owned trading subsidiary whose parent is operated by a registered CPO. This conclusion is consistent with the standard articulated in *Lopez v. Dean Witter*, 805 F.2d 880 (9th Cir. 1986), because the funds contributed to a wholly owned subsidiary are solicited and combined by the investee commodity pool into a single vehicle for the purpose of investing in derivatives, to be shared on a pro-rata basis among the investor pool’s participants. Staff does not believe that there is a meaningful distinction to draw between controlled foreign corporations operated by registered investment companies for the trading of derivatives and those wholly owned

trading subsidiaries of commodity pools that are operated for a similar purpose. Therefore, it is staff's position that wholly owned subsidiaries of commodity pools trading in derivatives are themselves commodity pools.

2. Should a CFC be exempt from providing disclosure documents and providing financial statements to its parent registered investment company, akin to a master-feeder fund arrangement?

CFCs should be treated as master funds for purposes of complying with Part 4 of the Commission's regulations. Therefore, as master funds, the CFCs would be exempt from providing disclosure documents and financial statements to investors under common control. See Commission regulations 4.20 and 4.22.

3. For CPOs of CFCs required to register with the Commission, what is their date for compliance with the Commission's regulations?

The CPO of a CFC must register with the Commission by the later of (i) December 31, 2012 or (ii) 60 days following the effective date of final rules defining the term "swap."

Forms CPO-PQR and CTA-PR

1. When can it be expected that the Commission will release additional guidance concerning Forms CPO-PQR and CTA-PR?

Staff has received multiple comments from industry that due to the fact that small and mid-sized CPOs and all CTAs are not required to make their first filing until 2013, many registrants have not yet reviewed the Forms or formulated requests for clarification. Because the staff expects that any guidance that is issued will be applicable to all filing entities, sufficient opportunity for requests for guidance must be made available to all potential filers. Therefore, staff has determined to defer releasing guidance with respect to Forms CPO-PQR and CTA-PR until such time as all filers have had adequate time to review and comment on any programmatic or other issues that may arise as a result of these forms.

Further, the Division understands that as large entities have more frequent filing obligations, to the extent that the Division does release guidance on the Forms, it is currently contemplated that the Division would not expect immediate compliance with such guidance.

With respect to filing such Forms prior to the issuance of any Division guidance, the Division believes that entities are entitled to make reasonable assumptions consistent with a good faith effort in executing their compliance obligations.

Regulation 4.13

1. If a fund that qualifies as a commodity pool enters into a swap before putting on its first deal, can the CPO rely on Regulation 4.13(a)(3)?

When establishing a fund that will predominantly invest in non-derivatives with some risk management being accomplished through de minimis swaps positions, it may be necessary to put the swaps position on first. Commission staff recognizes that due to certain deal structures, commodity interest positions are necessarily the first position entered into in furtherance of that structure and that following the completion of the deal the level of derivatives exposure will fall below the de minimis threshold.

Staff believes that CPOs claiming exemption under Regulation 4.13(a)(3) should have a reasonable time to comply with the required trading thresholds. Staff does not, however, believe that it is appropriate to specifically delineate what is a "reasonable time" because what may be considered reasonable may vary depending on the facts and circumstances of each CPO and pool. It should, however, be noted that any entity availing itself of a 4.13(a)(3) exemption is still subject to special calls to ensure that the CPO can demonstrate qualification under the terms of Regulation 4.13(a)(3).

2. Regulation 4.13(a)(3) includes a reference to former Regulation 4.13(a)(4), which permits U.S.-based operators of non-U.S. commodity pools that sold interests in such pools solely to non-U.S. persons to claim exemption. Given the rescission of Regulation 4.13(a)(4), does Regulation 4.13(a)(3) continue to include all QEPs and particularly non-U.S. persons as eligible investors?

Regulation 4.13(a)(3) continues to include all QEPs, particularly non-U.S. persons, as eligible investors. Commission staff intends to amend Regulation 4.13(a)(3) to make this inclusion explicit in the rule as a typographical correction that would not change the substance of the rule.

3. What is the compliance date for entities that need to register as a result of the amendments to Regulation 4.13?

For entities that claimed relief under Regulation 4.13(a)(4) prior to April 24, 2012, those CPOs would be required to register or claim exemption under Regulation 4.13(a)(3) by December 31, 2012.

4. For purposes of calculating "commodity interest" exposure, when will swaps be included?

Swaps will be included in the calculation of "commodity interest" on December 31, 2012. This will include all swaps entered into prior to that date and all swaps entered into going forward.

5. For an entity that has claimed exemption from registration because all of its operated pools qualified under Regulation 4.13(a)(4), if that CPO launches a new pool that would also qualify under Regulation 4.13(a)(4) after the effective date of the rescission of the Regulation, can that CPO operate the new pool without registering until December 31, 2012?

The Division issued a notice of no action relief on July 10, 2012, which is currently available on the Commission's website. CPOs should review the terms of the relief.

6. Do registered CPOs need to file 2012 annual reports for pools operated pursuant to Regulation 4.13(a)(4) that have the exemption withdrawn as of January 1, 2013?

CPOs do not need to file a 2012 annual report for pools that have their exemption under Regulation 4.13(a)(4) withdrawn on January 1, 2013. CPOs coming into registration will be required to file their first annual report for fiscal year 2013.

7. Prior to the effective date of the 2003 revisions to Regulation 4.13, the Commission permitted entities to file 4.13 No Action relief, without being required to designate a specific exemption type following the adoption of Regulations 4.13(a)(3) and (a)(4). As a result of the recent rescission of Regulation 4.13(a)(4) and the annual reaffirmation requirement, will I need to refile my exemption to designate that my pools are operating pursuant to Regulation 4.13(a)(3) or will I be able to reaffirm my current 4.13 No Action relief?

CPOs that have claimed exemption under the 4.13 No Action relief will need to refile their exemption to designate that the exempt pools are operating pursuant to Regulation 4.13(a)(3). If the pools do not qualify for exemption under Regulation 4.13(a)(3), the CPO will be required to register with the Commission by December 31, 2012.

Directors/Trustees

1. The Preamble of the Final Rule states that the Commission is not requiring registration of a mutual fund's board of directors where the mutual fund does not qualify for exclusion under Regulation 4.5. Are the directors and trustees of a mutual fund with an investment adviser that must now register as a CPO subject to potential liability under the CEA?

The board of directors is still subject to prohibitions under the CEA that are applicable to all market participants, including, but not limited to, the anti-fraud and anti-manipulation provisions. The CEA further provides a private right of action with respect to persons or entities that violate the CEA or willfully aid, abet, counsel, induce or procure the commission of a violation of the CEA. Division staff does not believe that exempting such actors from a private

cause of action due to willful conduct resulting in a violation of the CEA would be consistent with the Commission's mission to protect market users and the public from fraud, manipulation, abusive practices and systemic risk related to derivatives. Liability under the CEA does not supersede any potential liability arising under applicable state law.

Bona Fide Hedging

1. Does bona fide hedging include equitization of cash or risk management?

The Commission explicitly stated in the preamble to the final rules that equitization of cash and risk management are not properly included as bona fide hedging transactions for purposes of Regulation 4.5.

Trading Limits

1. Regulation 4.13(a)(3) requires that the trading limits must be complied with "at all times." Due to circumstances beyond the control of the CPO, the pool may exceed the trading threshold and, under the terms of the regulation, would be required to exit positions at a time that may be detrimental to the fund. Is there a reasonable time in which the CPO may correct the violation without being required to register?

Regulation 4.13(a)(3) requires that the trading limits must be complied with "at all times." However, the provisions of Regulation 4.13(a)(3) qualify that requirement, stating that such limits are determined "at the time the most recent position was established." When these requirements are read together, staff believes that it is clear that the regulation only requires that a CPO be in compliance with the trading thresholds at the time a position is established. A CPO would not otherwise be required to reconfigure its portfolio to comply with such limits.

2. Does the "liquidation value of the pool's portfolio" include cash or only the aggregate liquidation value of the fund's positions?

The liquidation value of the pool's portfolio includes all cash held by the pool.

3. Can commodity options with the same underlying be netted across designated contract markets and foreign boards of trade?

Yes, such options positions can be netted.

4. What is the notional value for cleared swaps?

For cleared swaps, the notional value of the swap is the amount reported by the reporting counterparty as the notional amount of the swap under Part 45 of the Commission's regulations.

5. What is the notional value for uncleared swaps?

For uncleared swaps, the notional value of the swap is the amount reported by the reporting counterparty as the notional amount of the swap under Part 45 of the Commission's regulations.

AP Registration

1. Does a Series 6 FINRA registered limited representative qualify for the exemption from registration as an Associated Person under Regulation 3.12(h)(1)(ii) with respect to the sale of shares of a mutual fund that does not qualify under the CPO exclusion under Regulation 4.5?

To the extent that a registered investment company no longer qualifies for exclusion under Regulation 4.5, it is staff's position that if the Series 6 licensee limits his activities to the sale of ownership interests in registered investment companies, the licensee should qualify for the exemption under Regulation 3.12(h)(1)(ii).

Commission Advisory 18-96

1. Is the relief available to registered CPOs under Commission Advisory 18-96 still available?

Commission Advisory 18-96 remains effective and registered CPOs can continue to claim relief pursuant to its terms.

Transitioning

1. Can a CPO of a pool that was previously exempt under Regulation 4.13(a)(4) claim relief under Regulation 4.7 despite the fact that the interests in the pool were offered and sold, and commodity interest transactions were entered into, prior to the filing of required notice under Regulation 4.7(d)?

The CPO may claim relief under Regulation 4.7 because the interests offered and sold were done so consistent with the then-effective provisions of Part 4.

2. Will CPOs operating pursuant to a 4.13(a)(4) exemption have to ensure that all of the participants in the existing 4.13(a)(4) pool meet the qualified eligible person standard for the CPO to claim a 4.7 exemption for that pool?

The CPO will not be required to reaffirm that all of the participants in an existing pool operated pursuant to Regulation 4.13(a)(4) continue to meet the qualified eligible person standard for the CPO to claim a Regulation 4.7 exemption. The CPO will, however, be required to ensure that any new participants meet the qualified eligible person standard at the time of investment to maintain a 4.7 exemption.

3. What, if any, grace period will be provided to an exempt CPO operating a 4.13(a)(4) pool that plans to pursue a 4.7 or 18-96 exemption effective January 1, 2013?

Division staff is working with the staff at NFA to permit CPOs to file an exemption under Regulation 4.7 or 18-96 prior to December 31, 2012 with an effective date of January 1, 2013. Therefore, at this time Division staff does not believe that a grace period will be necessary.

4. What do exempt CPOs who wish to avail themselves of relief under Regulation 4.7 have to do to start the process?

Currently, before a CPO can file an exemption under Regulation 4.7 on behalf of any of the pools that the CPO currently operates, the CPO must apply for registration with the Commission and NFA membership. This can be accomplished through NFA's Online Registration System (ORS). Once the CPO is pending registration as a CPO and NFA member, the CPO will be able to access NFA's Exemption System where the CPO can withdraw the exemption under Regulation 4.13(a)(4) and file the new exemption under Regulation 4.7. CPOs should be advised that withdrawing the Regulation 4.13(a)(4) exemption prior to December 31, 2012 could subject your firm to financial reporting requirements under Commission and NFA regulations.

Division staff is working with NFA to determine the appropriate mechanism to enable entities to claim relief under Regulation 4.7 and register while deferring the effective date of such registration and exemption until January 1, 2013.

5. What do exempt CPOs who wish to transition from being exempt under Regulation 4.13(a)(4) to being exempt under Regulation 4.13(a)(3) have to do?

The CPO must first submit a written request to NFA to withdraw the exemption under Regulation 4.13(a)(4). NFA will then contact the CPO when the exemption has been withdrawn. After the withdrawal has been finalized, the CPO may file the new exemption under Regulation 4.13(a)(3) electronically. The CPO must provide notice to participants of the change in exemption.

6. A CTA relied on the exemption from registration in Regulation 4.14(a)(8)(D) based on advice provided to a pool that was exempt under Regulation 4.13(a)(4). Can this CTA claim relief under Regulation 4.7(c) despite the fact that it provided advice to the pool prior to filing the required notice under Regulation 4.7(d)?

A CTA may claim relief under Regulation 4.7(c) because the advice was provided pursuant to a then-effective exemption from registration.

Compliance Dates

1. For entities required to register due to changes in Regulation 4.5, what is the compliance date?

The compliance date for CPOs of registered investment companies to register with the Commission is the later of December 31, 2012 or 60 days following the effective date of final rules defining the term “swap.”

2. What is the compliance date for CPO registration of advisers to new registered investment companies that are launched after April 24, but before the compliance date?

CPOs of such funds will be required to register on January 1, 2013.

3. Sub-advisors to registered investment companies that were excluded under former Regulation 4.5 generally relied upon the exemption from CTA registration in Regulation 4.14(a)(8) with respect to the advice provided to the registered investment company. If the CPO of the registered investment company is required to register due to the amendments to Regulation 4.5, the sub-advisor will no longer be able to rely on Regulation 4.14(a)(8). When would such an advisor be required to comply with Part 4 of the Commission’s regulations?

For a sub-advisor of a registered investment company that can no longer rely on Regulation 4.14(a)(8) because the CPO of the registered investment company cannot rely on amended Regulation 4.5, registration for that sub-advisor will be required when the CPO for the registered investment company would be required to register. The CTA’s compliance with the Commission’s recordkeeping, reporting, and disclosure requirements pursuant to Part 4 of the Commission’s regulations is not required until 60 days following the effective date of a final rule implementing the Commission’s proposed harmonization effort.

4. When are swaps required to be included within the trading threshold under Regulation 4.5?

Swaps are required to be included within the trading threshold under Regulation 4.5 by the later of either December 31, 2012 or 60 days after the publication date of the final rulemaking further defining the term “swap.” The final rule was adopted in July and staff believes that CPOs will have sufficient time prior to December 31, 2012 or 60 days after the publication date of the final rulemaking further defining the term “swap” to conduct the necessary calculations to determine eligibility under Regulation 4.5 and complete the registration process if necessary.

Staff also believes that it is not necessary to delay compliance with the inclusion of swaps within the threshold until the finalization of the margin requirements for uncleared swaps. CPOs should have the necessary information regarding margin payments made for their current swaps portfolio to calculate whether the operated pool exceeds the trading threshold. Moreover, the Commission clearly stated its intention regarding retroactive application of the margin requirements in the release proposing margin rules for uncleared swaps. The Commission stated that the “proposal would only cover swaps executed after the effective date of the regulation that are not cleared by a [derivatives clearing organization].” 76 FR 23732, 23734 (Apr. 28, 2011). The Commission further stated its belief that “the pricing of existing swaps reflects the credit arrangements under which they were executed and that it would be unfair to the parties and disruptive to the markets to require that the new margin rules apply to those positions.” *Id.* The Division believes that it should not be necessary to wait until the margin rules are finalized for CPOs to be capable of calculating the initial margin for uncleared swaps entered into prior to the effective date of that rule.

Funds-of-funds

1. Can CPOs of funds-of-funds continue to rely on Appendix A until such time as the Commission adopts revised guidance?

CPOs of funds-of-funds may continue to rely on Appendix A until the Commission adopts revised guidance.