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VIA E-MAIL

To Our Investment Adviser Clients and Other Friends

Re: CFTC Rescinds Exemption from CPO Registration; Forthcoming Regulations on Investment Advisers that Trade Swaps

Summary. On February 9, 2012, the Commodity Futures Trading Commission (the "CFTC") issued final regulations (the "Final Rules") that eliminate the exemption from registration as a commodity pool operator (a "CPO") in CFTC Rule 4.13(a)(4). The Rule 4.13(a)(4) exemption is available to CPOs of private funds that invest in futures and other commodity interests (together, "Commodity Interests") and that are offered only to highly sophisticated investors. The investment adviser to a fund is generally the fund's CPO. Because "qualified purchasers" under section 3(c)(7) of the Investment Company Act of 1940 (the "ICA") satisfy the sophistication requirement of Rule 4.13(a)(4), CPOs of 3(c)(7) funds that invest in Commodity Interests typically have relied on the Rule 4.13(a)(4) exemption. If such an adviser intends to continue to invest in Commodity Interests after the Final Rules become effective, it will need to qualify for another exemption or register with the CFTC as a CPO.

The elimination of the Rule 4.13(a)(4) exemption will, however, affect a larger group of fund advisers than those that trade Commodity Interests, because the CFTC and the SEC are now finalizing regulations mandated by the Dodd-Frank Act that will bring many over-the-counter derivatives within the jurisdiction of the CFTC. When these regulations (which are not part of the Final Rules) become effective, advisers to funds that invest in many types of swaps will be deemed CPOs, even if they do not invest in Commodity Interests. As CPOs, they will be required to register with the CFTC unless they qualify for an exemption. The revocation of the Rule 4.13(a)(4) exemption eliminates one of the most likely means by which those advisers would have been able to avoid CFTC registration.

Effective Date of Final Rules. The Final Rules will become effective 60 days after they are published in the Federal Register, which is likely to occur soon. A CPO that claims the Rule 4.13(a)(4) exemption for a fund before the effective date may continue to rely on it until December 31, 2012. Beginning on the effective date, however, a CPO will no longer be allowed to file a new claim for the Rule 4.13(a)(4) exemption. The exemption must be claimed separately for each fund, and therefore a CPO that claims the Rule 4.13(a)(4) exemption with respect to a fund before the effective date and organizes a new fund after that date will not be able to rely on the exemption for the new fund.

By December 31, 2012, a CPO that currently relies on the Rule 4.13(a)(4) exemption with respect to a fund must either cease trading Commodity Interests (and many swaps, if the regulations defining "swap" become effective by that date) in that fund, qualify for another exemption from CPO registration (see the discussion below about the Rule 4.13(a)(3) exemption), or register with the CFTC.

New Regulations Regarding Swaps. Because swaps are not yet regulated by the CFTC, investment advisers to funds that invest in swaps but not Commodity Interests are not currently CPOs and therefore are not subject to CFTC regulation. The Dodd-Frank Act expanded the definition of "commodity pool" to include funds that invest in swaps and directed the CFTC and the SEC to define "swap." Although the agencies' efforts to agree on a definition have been protracted and controversial, the definition is expected ultimately to encompass many over-the-counter derivatives, including swaps on broad-based securities indices and interest rate, currency, total return and most other financial swaps, but excluding "security-based swaps," which include swaps on single securities and narrow-based securities indices.

On the effective date of the rules that define "swap" (the "Swap Regulations"), investment advisers to funds that invest in swaps will be treated as CPOs. By that date, they will need to have exited the swaps markets, claimed an available exemption from CPO registration (such as the Rule 4.13(a)(3) exemption described below), or registered as CPOs. The content and effective date of the Swap Regulations remain uncertain; they may become effective before or after December 31, 2012. Accordingly, any adviser to a fund that invests in derivatives should contact us to assess whether the instruments it trades are likely to be included in the new "swap" definition. If so, the adviser should evaluate its eligibility for the Rule 4.13(a)(3) exemption or develop a timetable for registering as a CPO.

Alternative Rule 4.13(a)(3) Exemption from CPO Registration for Advisers that Have Relied on Rule 4.13(a)(4). The other exemption from CPO registration that is widely used by CPOs of private funds is the *de minimis* exemption in Rule 4.13(a)(3), which will be retained under the Final Rules. This exemption is available with respect to funds whose investments in Commodity Interests are very limited. A fund may qualify for it if either (a) the aggregate initial margin and premiums required to establish the fund's positions in Commodity Interests do not exceed 5% (measured when the most recent position was established) of the liquidation value of the fund's portfolio, taking unrealized profits and losses into account, or (b) the aggregate net notional value of the fund's positions in Commodity Interests is not greater than the portfolio's liquidation value. The exemption also requires that the fund be privately offered and not marketed as a vehicle for trading Commodity Interests. The Rule 4.13(a)(3) exemption imposes less strict investor qualifications than the Rule 4.13(a)(4) exemption, generally requiring only that U.S. investors in the fund be accredited investors as defined in Regulation D under the Securities Act of 1933 or knowledgeable employees. For that reason, the Rule 4.13(a)(3) exemption is widely used by CPOs of funds that rely on the exclusion from the definition of "investment company" in ICA section 3(c)(1).

Funds that invest in Commodity Interests mainly for hedging purposes can usually stay within the *de minimis* trading limits of the Rule 4.13(a)(3) exemption. When the Swap Regulations become effective, however, a CPO that invests in swaps will likely be required to take them into account, along with its Commodity Interest trading, in determining whether its funds comply with the Rule 4.13(a)(3) trading limits. This will reduce the universe of advisers that qualify for the Rule 4.13(a)(3) exemption.

A CPO that currently relies on the Rule 4.13(a)(4) exemption with respect to a fund and intends to switch to the Rule 4.13(a)(3) exemption must provide specified disclosure to the fund's investors and file a new claim of exemption with the National Futures Association (the "NFA") before December 31, 2012. Although CPOs are currently required to file a claim of exemption for a fund only once, the Final Rules will require CPOs to reaffirm their claims of exemption with the NFA annually within 60 days after the end of each calendar year. The first such reaffirmation filing must be made by March 1, 2013.

Registering as a CPO. CPOs of funds whose Commodity Interest trading exceeds the Rule 4.13(a)(3) limits and that are unwilling to curtail such trading will need to register with the CFTC as CPOs by December 31, 2012 (or possibly earlier depending on the effective date of the Swap Regulations). To register, a CPO must submit registration forms electronically to the NFA, pay application fees, submit fingerprints for each principal and associated person, and have each associated person pass the FINRA Series 3 examination (unless such person qualifies for an exemption from the examination requirement). The registration process typically takes at least two or three months. A registered CPO must become a member of the NFA, which requires annual dues and compliance with NFA conduct rules.

Obligations of Registered CPOs. A registered CPO must undergo annual ethics training and is subject to periodic examinations by the NFA. A registered CPO must also include specified disclosure in its fund offering documents, provide specified reports to the CFTC and investors in its funds, and submit its fund offering documents to the NFA for review.

A registered CPO may avoid some of these requirements, including the NFA offering document review, with respect to any fund that complies with CFTC Rule 4.7. The Rule 4.7 relief is available for funds that are offered only to "qualified eligible participants," which include "qualified purchasers" under ICA section 3(c)(7), non-U.S. persons, knowledgeable employees, and accredited investors that satisfy specified portfolio thresholds. Because of the significant overlap between the investor eligibility requirements of the Rule 4.13(a)(4) exemption and the Rule 4.7 relief, CPOs of funds that currently qualify for the Rule 4.13(a)(4) exemption will usually be able to claim the Rule 4.7 relief if they are required to register as CPOs. (Certain entities that are accredited investors, however, satisfy the eligibility requirements of the Rule 4.13(a)(4) exemption but are not "qualified eligible participants" under Rule 4.7.) The Rule 4.7 relief is claimed by filing a notice with the NFA, which must be reaffirmed annually.

New Reporting Requirements for Registered CPOs. The Final Rules will require registered CPOs to file reports with the NFA that are intended to allow the NFA to monitor systemic risk. Registered CPOs will file Form CPO-PQR, which reports various identifying and operating data of the CPO and is similar to new SEC Form PF. The information to be reported on Form CPO-PQR differs based on the aggregate gross AUM of the funds the CPO operates and any separate accounts it manages using substantially the same strategy as any of its funds. Every CPO must disclose its total AUM, service providers and information about each fund it operates, including monthly performance and redemption terms. CPOs with AUM of $150 million or more must furnish additional information on Form CPO-PQR, including investment strategy, borrowings, types of creditors, counterparty credit and exposure, and a schedule of investments. Still more information is required from CPOs with AUM of $1.5 billion or more, including geographic breakdowns of investments. In an effort to harmonize the CFTC and SEC reporting requirements, the Final Rules provide that a CPO that is also registered with the SEC as an investment adviser and files SEC Form PF does not need to complete the items on Form CPO-PQR that request the same information that it reports on its Form PF.

Registered CPOs with AUM of $1.5 billion or more must file Form CPO-PQR quarterly within 60 days after the end of each calendar quarter. Registered CPOs with AUM under $1.5 billion must file Form CPO-PQR annually within 90 days after the end of each calendar year.

The first Form CPO-PQR filing is due November 29, 2012, for CPOs with AUM of $5 billion or more; March 1, 2013, for CPOs with AUM between $1.5 billion and $5 billion; and April 1, 2013, for CPOs with AUM under $1.5 billion.

Effect of Final Rules and Swap Regulations on CTAs. In addition to serving as CPOs, investment advisers to funds that invest in Commodity Interests (or certain swaps, when the Swap Regulations become effective), are the commodity trading advisers ("CTAs") of those funds. Advisers to separately managed accounts that invest in Commodity Interests are also CTAs. CTAs are required to register with the CFTC, unless they qualify for an exemption from CTA registration. Most CPOs that rely on the rule 4.13(a)(4) exemption from CPO registration have also been able to rely on an exemption from CTA registration in Rule 4.18(a)(8). The Final Rules will rescind the Rule 4.18(a)(8) exemption.

Many CTAs, however, are eligible for other exemptions from registration, which are retained under the Final Rules. These include an exemption for a CTA that has furnished investment advice about Commodity Interests to no more than 15 clients (a fund counts as a single client) in the preceding 12 months and that does not hold itself out to the public as a CTA. Another exemption is available to a CTA that is registered as an investment adviser with the SEC, whose business does not consist primarily of acting as a CTA, and that does not act as a CTA to any fund engaged primarily in trading Commodity Interests.

A CTA that invests in swaps may be less able to qualify for these exemptions when the Swap Regulations become effective. In addition to expanding the definition of "commodity pool" to include funds that invest in swaps, the Dodd-Frank Act expanded the definition of "commodity trading adviser" to include advisers that provide advice regarding swaps. The Swap Regulations will therefore cause investment advisers to funds and separate accounts that invest in certain types of swaps to be treated as CTAs. When the Swap Regulations become effective, a CTA will be required to take those swaps, in addition to its Commodity Interests, into account in determining whether it is eligible for any exemption from CTA registration that limits the number of accounts it may manage without registration or the extent of its trading in Commodity Interests.

The Final Rules impose new reporting obligations on registered CTAs, including requiring that they file reports on Form CTA-PR with the NFA annually within 45 days after the end of each calendar year. Form CTA-PR is similar to, but much less extensive than, the Form CPO-PQR that registered CPOs are required to file. The first Form CTA-PR will be due February 14, 2013.

This letter only generally summarizes the Final Rules and very limited aspects of the proposed Swap Regulations. It is not intended as specific or complete advice and is subject to change if and when the Swap Regulations are adopted or the CFTC issues additional regulations or interpretations. If you need assistance in determining the effects of these developments on your business, or preparing to comply with them, please contact Doug Hammer, John Broadhurst, Geoff Haynes, Chris Rupright, Carolyn Reiser, Neil Koren, Jim Frolik, Joan Grant, Ellyn Roberts, Anthony Caldwell, Christina Hamilton or Charles Clinger.

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