

Corporate & Financial Weekly Digest

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CFTC Revision of Rule 4.5 Requires Advisers to Certain Registered Investment Companies to Register with the CFTC; CFTC Separately Proposes to Harmonize Investment Company Rules with SEC Requirements

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Rule 4.5 Amendment. On February 9, the Commodity Futures Trading Commission (CFTC) adopted final amendments to its Part 4 Rules, which set out the registration and compliance obligations for commodity pool operators (CPOs) and commodity trading advisors (CTAs). CFTC Rule 4.5 formerly provided a blanket exemption from CFTC registration and associated regulatory requirements for registered investment companies and their advisers. Amended Rule 4.5 is a step back to the rule as it existed before 2003, with certain modifications, where an adviser of a registered fund that trades over a de minimis amount of futures contracts, options on futures or swaps (Derivatives) or otherwise markets the fund as a commodity fund will be required to register as a CPO.

To qualify for the new Rule 4.5 CPO exception, an investment company's adviser must represent to the CFTC that the fund will only use Derivatives solely for "bona fide hedging purposes." That term is narrowly construed and does not include strategies that are commonly referred to as "risk management." The adviser to a registered fund that cannot qualify for the bona fide hedging exemption will be subject to CPO registration requirements unless the fund otherwise uses Derivatives within either of the following thresholds:

- the aggregate initial margin and option premiums for non-hedging Derivatives will not exceed 5% of the fund's liquidation value (excluding the in-the-money amount of any in-the-money option at the time of purchase); or
- the aggregate net notional value of non-hedging Derivatives, determined at the time the most recent position is established, does not exceed 100% of the fund's liquidation value.

The thresholds must be calculated after taking into account unrealized profits and losses on the non-hedging Derivatives already held. The final rule provides detailed

instructions on determining net notional value that allow netting of futures positions in the same commodity across designated contract markets and foreign boards of trade while limiting netting of swaps only to those cleared by the same derivatives clearing organization.

Finally, the fund's adviser must represent to the CFTC that the fund has not been, and will not be, marketed as a commodity pool or as a vehicle for trading in the Derivatives markets. The claim for the new Rule 4.5 CPO exclusion must be filed with the CFTC by the compliance date or, for new funds created after the compliance date, before the inception of the fund. In either case, an affirmation must be filed within 30 days of each calendar year-end.

While the amendments to Rule 4.5 become effective on July 2, 2012, compliance is not required before the later of (1) December 31, 2012, or (2) 60 days after the CFTC adopts a final rule defining the term "swap." Advisers required to register as CPOs solely by virtue of Rule 4.5 will become subject to the Part 4 reporting, disclosure and recordkeeping requirements within 60 days of the adoption by the CFTC of final rules that implement a proposed CFTC initiative to harmonize certain of its rules with those of the Securities and Exchange Commission (SEC).

CFTC Proposed Harmonization Initiative. Also on February 9, the CFTC proposed amendments to certain CPO reporting, disclosure and recordkeeping rules to harmonize the obligations of registered investment companies that otherwise might be subject to duplicative, inconsistent, and possibly conflicting, SEC requirements under the Investment Company Act of 1940. The CFTC proposes to amend Rule 4.12(c) to offer relief from the disclosure document delivery and acknowledgement requirements under Rule 4.21, certain periodic financial reporting obligations under Rule 4.22 and the requirement that records be maintained at the CPO's main office under Rule 4.23. The CFTC is also soliciting comments as to, among other things, whether further relief is needed.

To review the full final rule release of the CFTC, please click [here](#). For the proposed harmonizing release, please click [here](#). For more information on the CFTC's rulemaking on February 9, please click here to view the entry under **Private Investment Funds**.

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