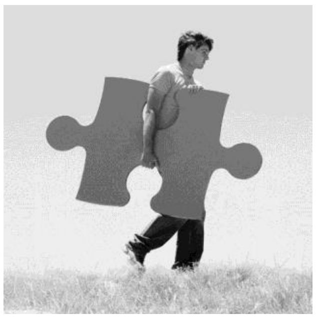
News Bulletin

April 10, 2013



The CFTC's Further No-Action Relief for Operators of Securitization Vehicles that May Constitute Commodity Pools

In a letter dated March 29, 2013[1] (the "March 29 Letter"), the Division of Swap Dealer and Intermediary Oversight (the "Division") of the Commodity Futures Trading Commission (the "CFTC"), extended by three months, but subject to new and stringent conditions, no-action relief that the Division had previously given for operators of securitization vehicles (each, an "SV") possibly falling within the definition of "commodity pool"[2] by reason of the SV's trading in swaps. In view of the CFTC's ongoing discussions with the securitization industry regarding compliance issues, and the undetermined nature of any additional relief that the Division might provide, the March 29 Letter states that, subject to conditions, the Division will not recommend enforcement action against the commodity pool operator ("CPO") of an SV for failure to comply fully with Part 4 of the CFTC's regulations ("Commodity Pool Operators and Commodity Trading Advisors") until June 30, 2013.[3] In a previous letter issued on December 7, 2012 (the "December 7 Letter"), the Division had, in addition to giving guidance as to the nature of derivatives trading that might permit an SV to remain permanently excluded from the definition of "commodity pool," granted no-action relief until March 31, 2013, for any operator of an SV not registering as a CPO.[4]

The temporary relief provided by the March 29 Letter is subject to significant conditions that did not apply to the temporary relief previously provided by the December 7 Letter, most notably the requirement that, in the period of time before June 30, the CPO of an SV must comply with all applicable provisions contained in Part 4 of the CFTC's regulations, as those regulations are modified for purposes of the March 29 Letter.[5] Because the CFTC may offer additional relief for operators of SVs, such as further exclusions from the definition of "commodity pool," this requirement appears to mean that operators of SVs must, until June 30, comply with many regulations applicable to CPOs even though such compliance may later be determined to be unnecessary. In addition, under the March 29 Letter, an SV's operator must (i) give email notice to the Division with reference to the no-action relief and (ii) have initiated registration as a CPO no later than March 31, 2013, by filing required forms and paying required fees.[6]

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[1] CFTC Letter No. 13-07, No-Action, March 29, 2013, Division of Swap Dealer and Intermediary Oversight, "Time-Limited No-Action Relief for Securitization Vehicles Regarding Compliance with Part 4 of the Commission's Regulations."

[2] The possibility that an SV might be characterized as a commodity pool arises primarily because the Dodd-Frank Wall Street Reform and Consumer Protection Act amended the definition of "commodity pool" to include enterprises that are operated "for the purpose of" trading in swaps. The definition of "commodity pool," contained in § 1a(10) of the Commodity Exchange Act (the "CEA"), includes any "investment trust, syndicate, or similar form of enterprise operated for the purpose of trading in commodity interests," which now include, among other things, any swap. Under CEA § 1a(10)(B), the CFTC, "by rule or regulation, may include within, or exclude from, the term 'commodity pool' any investment trust, syndicate, or similar form of enterprise if the Commission determines that the rule or regulation will effectuate the purposes" of the CEA.

[3] March 29 Letter at 1.

[4] CFTC Letter No. 12-45, Interpretation and No-Action, December 7, 2012, Division of Swap Dealer and Intermediary Oversight, "Further Exclusions from Commodity Pool Regulation for Certain Securitization Vehicles; No-Action Relief for Certain Securitization Vehicles Formed Prior to October 12, 2012" at 1-4, 6.

[5] March 29 Letter at 1.

[6] Id. at 1, 2.

For purposes of CPOs' interim compliance with Part 4 of the CFTC's regulations until June 30, 2013, the March 29 Letter modifies Part 4 of the CFTC's regulations to reflect the following requirements and exclusions:

Requirements:

- With regard to the requirement under CFTC regulation 4.24(h) that a CPO disclose the percentage of a commodity pool's assets that is used to trade commodity interests, a CPO with respect to an SV that holds static swap positions is required to provide, in addition to such percentage, full and complete disclosure regarding the swaps and their functions within the SV.

- Instead of distributing to pool participants financial statements as required by CFTC regulation 4.22, the CPO of an SV must provide "material information concerning the structure of the securities and distributions thereon, the nature, performance and servicing of the assets supporting the securities, and any swaps held in [the SV's] portfolio, including a discussion of [the SV's] counterparties."[7]

- With respect to CFTC regulation 4.13(a)(3), which provides an exemption from CPO registration, the CPO of an SV not paying any initial margin with respect to the SV's swaps positions is required to use the alternative net notional test contained in CFTC regulation 4.13(a)(3)(ii)(B) to determine the operator's eligibility for exemption from CPO registration under that section.

- For purposes of calculating an SV's net asset value, fixed income securities rated "BB" and higher are to be treated as debt, and all other fixed income securities and equity tranches are to be treated as equity.[8]

Exclusions:

- The CPO of an SV "comprised of a static pool of assets that does not have either an equity tranche or debt issuances rated lower than BB" [9] is not required to comply with CFTC regulation 4.25, relating to disclosures of performance, with respect to that SV.

- The CPO of an SV with an amortizing pool of assets is not required to comply with CFTC regulation 4.25(a)(1)(F) and (G), which require information regarding the largest draw-downs in the most recent five calendar years, with respect to that SV.

- The CPO of an SV is not required to comply with the following CFTC regulations:

    - regulation 4.21(b), under which a CPO may not accept funds from a prospective participant unless the operator receives a written acknowledgment that the prospective participant has received the commodity pool's disclosure document;

    - regulations 4.24(a) and (s), under which a commodity pool's disclosure document must contain, among other things, (i) a statement that the CFTC has not passed on the merits of a particular pool and (ii) information as to the minimum subscriptions necessary for the commodity pool to commence trading in commodity interests; and

[7] Id. at 2
[8] Id.
[9] Id.

- regulation 4.23, with regard to the requirement that books and records be maintained at the main business office with respect to the SV.[10]

Between now and June 30, 2013, when the no-action relief contained in the March 29 Letter is scheduled to expire, the CFTC will have an opportunity to clarify its guidance and, market participants hope, further broaden the permanent relief that it has granted, with respect to SVs potentially subject to regulation as commodity pools. In an initial no-action letter last year[11], the Division stated that an SV would not constitute a commodity pool if, among numerous other things, the issuer of the asset-backed securities were operated in a manner consistent with the conditions set forth in Regulation AB[12] or Rule 3a-7.[13] In the December 7 Letter, the CFTC broadened this relief, excluding from the definition of "commodity pool" certain SVs not satisfying the trading or operating limitations contained in Regulation AB or Rule 3a-7, so long as (i) the relevant SV's activities are limited to passive ownership and holding of financial assets, either fixed or revolving, that by their terms will be converted to cash, and certain other rights or assets and (ii) the SV's use of derivatives is limited to uses permitted under Regulation AB, including credit enhancement and the alteration of payment characteristics of cash flows of the SV's assets by means of interest rate or foreign currency swaps.[14] Among the types of SVs that could, depending on the nature and extent of their use of derivatives, fall outside the definition of "commodity pool" are asset-backed commercial paper conduits, collateralized debt obligations and special purpose vehicles used in relation to covered bond transactions.[15]

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[10] Id.
[11] CFTC Letter No. 12-14, Interpretation, October 11, 2012, Division of Swap Dealer and Intermediary Oversight, "Request for Exclusion from Commodity Pool Regulation for Securitization Vehicles."
[12] 70 Fed. Reg. 1506 (January 7, 2005). Regulation AB sets out detailed rules addressing registration, disclosure and reporting requirements for asset-backed securities.
[13] 17 CFR 270.3a-7. Rule 3a-7 sets out the requirements for issuers of asset-backed securities not to constitute investment companies for purposes of the Investment Company Act of 1940.
[14] December 7 Letter at 3, 2.
[15] Id. at 3-4.

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