



*To Register or not to Register as a Commodity Pool Operator...  
the Repeal of the 'Sophisticated Investor' Exemption  
and the Regulatory Impact on Hedge Fund and Private Equity Fund Managers*

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On February 9, 2012, the Commodity Futures Trading Commission (the “CFTC”) adopted final rules (the “**Final Rules**”)<sup>1</sup> rescinding the Rule 4.13(a)(4) exemption from registration as a commodity pool operator (“CPO”) (otherwise known as the ‘sophisticated investor’ exemption) previously relied upon by many hedge fund and private equity fund managers. Fund managers currently utilizing this exemption face registration and potentially far-reaching disclosure, reporting and compliance requirements. Consequently, fund managers who seek to launch a new fund may need to register with the National Futures Association (“NFA”), unless another exemption is available. Non-exempt fund managers and certain employees will also be subject to regulation, including, among other things, registering as associated persons and being required to pass the Series 3 proficiency examination.

This article seeks to provide a brief introduction on CPOs and commodity pools, and the jurisdictional reach of the CFTC with respect to CPOs. In addition, this article addresses, and provides an overview of, the following, which is critical to a fund manager’s understanding of the current CPO regulatory regime: (i) the Final Rules rescinding the Rule 4.13(a)(4) exemption; (ii) the Rule 4.13(a)(3) exemption from registration as a CPO (the “*de-minimis* exemption”), including the amendments made to such exemption under the Final Rules; (iii) certain CPO exemptions available to non-US fund managers; (iv) certain commodity trading adviser (“CTA”) exemptions available to fund managers; (v) registration and filing requirements for principals and associated persons of CPOs; (vi) relief available to registered CPOs from certain disclosure, recordkeeping and reporting requirements under Rule 4.7, otherwise known as ‘*Registration Lite*’; (vii) Form CPO-PQR; and (viii) the consequences of non-compliance with CFTC registration and reporting requirements.

A CPO is anyone engaged in a business that is of 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 for the purpose of trading in CFTC regulated derivatives or ‘commodity interests’ (which includes futures, securities futures, swaps, retail forex or commodity transactions defined under the Commodity Exchange Act of 1976, as amended (“CEA”).<sup>2</sup> Commodity pools are typically defined as collective investment vehicles that trade commodity interests. In the fund context, a CPO would generally be the general partner of a limited partnership, the managing member or manager of a limited liability company, the trustees of a trust, the directors of a corporation, or the investment adviser of a non-U.S. company (e.g., a Cayman exempted company). Fund managers that trade commodity interests will be subject to CFTC regulation, including a non-U.S. fund manager, even if that non-U.S. fund manager does not solicit or accept

<sup>1</sup> 77 Fed. Reg. 11,252 (February 24, 2012).

<sup>2</sup> 7 U.S.C. § 1A(10).

investments from U.S. investors. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “**Dodd-Frank Act**”) further expanded the reach of the CEA. The definitions of CTA and CPO have now been expanded to include persons or entities that advise with respect to (non security-based) swaps, and the definition of commodity pool has been amended to include swaps.<sup>3</sup> As a result, any fund manager that trades swaps or commodity interests, even if for purely hedging purposes, will be required to register as a CPO and a CTA, unless an exemption is available.

Absent an exemption, a CPO would be required to register with, and become a member of the NFA, the self-regulatory organization responsible for overseeing and regulating the futures industry. As a NFA member, fund managers that are CPOs are required to, among other things: (1) provide certain disclosures to pool participants; (2) comply with advertising and marketing rules; (3) distribute annual audited financial statements to pool participants; and (4) implement compliance policies and procedures. While the Final Rules rescinded the sophisticated investor exemption, it did preserve, albeit in amended form, the *de minimis* exemption, which fund managers may be able to utilize to avoid registration as a CPO.

#### **Rescission of the CPO Exemption under Rule 4.13(a)(4)**

In the past, fund managers could avoid registration as a CPO by filing a notice of exemption with the NFA under Rule 4.13(a)(4) if each commodity pool it managed satisfied the following requirements: (i) interests in the pool were exempt from registration under the Securities Act of 1933, as amended (the “**Securities Act**”), and were offered and sold without marketing to the public in the United States; and (ii) the manager believed at the time of investment that (A) each natural person participant was a “qualified eligible person” as defined under the CFTC rules (“**QEPs**”) or (B) each entity participant qualified as a certain type of “accredited investor,” as defined under Regulation D of the Securities Act. Fund managers that advised private investment funds relying on the exclusion from the definition of investment company under Section 3(c)(7) of the Investment Company Act of 1940, as amended (the “**Company Act**”), often utilized this exemption since its investors were required to be “qualified purchasers,” as defined under Section 2(a)(51) of the Company Act, and investors that are qualified purchasers also qualify as QEPs. Following the recent economic turmoil, the CFTC reconsidered the level of regulation it believed appropriate with respect to entities participating in the commodities and derivatives markets. The CFTC determined this past February that rescinding the Rule 4.13(a)(4) exemption was necessary to ensure CPOs were subject to a similar registration and reporting regime as investment advisers registered with the Securities and Exchange Commission (“**SEC**”) as a result of the Dodd-Frank Act. A fund manager that filed a notice of exemption under Rule 4.13(a)(4) with the NFA prior to April 24, 2012 for any commodity pool it manages will be entitled to avail itself of such exemption until **December 31, 2012**. All other fund managers that do not have a Rule 4.13(a)(4) exemption notice on file prior to April 24, 2012 must register as a CPO or qualify for a new exemption.

#### **The *De-Minimis* Exemption – New Amendments under the Final Rules**

The Final Rules leave the *de minimis* exemption, intact, but with some notable amendments. Under the *de minimis* exemption, CPOs may engage in limited trading of commodity interests. The trading limitations are measured by satisfying one of two tests: (1) the aggregate initial margin and premiums do not exceed 5% of the liquidation value of the pool’s portfolio (after taking into account unrealized profits and losses); and (2) the aggregate net notional value of positions do not exceed 100% of the liquidation value of the pool’s portfolio (after taking into account unrealized profits and losses).<sup>4</sup> It is important to note that, unlike the regulatory assets under management buffers under the Investment Advisers Act of 1940, as amended (the “**Advisers Act**”), there are no notional value buffers in respect of the *de minimis* exemption; if a fund manager exceeds the trading limitations at any point in time, the fund manager will be required to register as a CPO.

Of particular concern for fund managers when relying on the *de minimis* exemption is the calculation of “notional value.” Under the Final Rules, ‘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), 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), by the strike price per unit; for each retail forex position, 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 position by the value determined consistent with the terms of 17 C.F.R. part 45.<sup>5</sup> In addition, a fund manager may net futures contracts with the same underlying commodity across designated contract markets and foreign boards of trade as well as swaps cleared on the same derivatives clearing organization where appropriate.<sup>6</sup>

Title VII of the Dodd-Frank Act provides the current definition of “swaps,” but it also calls for the CFTC to promulgate rules for the regulation of swaps. Under Title VII of the Dodd-Frank Act, the following products are defined as swaps and subject to CFTC jurisdiction:

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<sup>3</sup> The amendment to the CPO definition including the term “swap” will not take effect until the adoption of final rules further defining the term “swap.”

<sup>4</sup> CFTC Rule 4.13(a)(3).

<sup>5</sup> Notional value is not defined for uncleared swaps.

<sup>6</sup> 77 Fed. Reg. 17329 (March 26, 2012).

credit default swaps referencing a broad-based security index<sup>7</sup>; credit default swaps referencing more than one loan or any loan index; total return swaps referencing a broad-based security interest (comprising either debt or equity securities); total return swaps referencing more than one loan; equity variance and dividend swaps referencing a broad-based security index; correlation swaps referencing a broad-based security index and any commodity or commodity index (including FX rates and rate indices/indexes); interest rate swaps; FX swaps and forwards (subject to potential exemptions that may be recommended by the Treasury Department); OTC options on or referencing any asset other than an option on a security or a certificate of deposit or group or index of securities; commodity swaps; weather, energy and emissions swaps; other swaps referencing broad-based (as opposed to narrow-based) securities indices, government securities and most other reference assets; and swaptions on any of the above.

The CFTC stated in the Final Rules that it will not implement the inclusion of swaps within the trade limitation test for the *de minimis* exemption prior to the effective date of final rules promulgated by the CFTC further defining “swaps.” On July 10, 2012, the CFTC voted 4 to 1 in favor of the final rule further defining “swaps,” which means two months after the final rule is published in the Federal Register, fund managers will be required to include swaps in the calculation of notional value under the *de minimis* exemption. Therefore, fund managers with limited commodity interest exposure in their portfolio (but trade swaps which will be subject to CFTC jurisdiction under the final rule) will have a very short window to avail themselves of the *de minimis* exemption. In light of the imminent compliance date for inclusion of swaps in calculating the trade limitation test, fund managers should consult with counsel on the registration process and other exemptions that may be available under the CEA and CFTC rules.

There are a number of additional requirements to consider in order to qualify for the *de minimis* exemption. Funds must not market themselves as trading in commodity futures, commodity options or swaps’ markets and participants in the pool must be limited to “accredited investors” or “knowledgeable employees” as defined under Rule 3c-5 of the Company Act.<sup>8</sup> CPOs relying on the *de minimis* exemption will continue to file a notice of exemption with the NFA before a subscription agreement is delivered to a prospective investor in the pool. In addition, the Final Rules now require the notice filing to be updated within 60 days of the end of each calendar year affirming a CPO’s ability to continue to rely on the exemption. If a CPO cannot comply with the foregoing requirement, it will be required to register with the NFA as a CPO. For existing funds, the first notice filing is required for the calendar year ending December 31, 2012.<sup>9</sup>

### **Exemptive Relief for Non-US Fund Managers**

The CFTC declined to adopt a “foreign adviser exemption” similar to the “foreign private adviser” exemption from registration as an investment adviser adopted under Title IV of the Dodd-Frank Act. The CFTC expressed concern in the Final Rules over the lack of information regarding the activities of these CPOs and believed it prudent to defer consideration of a foreign adviser exemption until it receives data regarding non-US fund managers on Form CPO-PQR and/or Form CTA-PR, as applicable, before making a determination to adopt such an exemption. Nothing, however, prevents non-US fund managers from relying on the *de minimis exemption* outlined above as well as other exemptions available to CPOs, including other exemptions available specifically for non-US fund managers. Non-US managers may rely on CFTC Rule 30.5 which exempts non-US fund managers from CPO and CTA registration if they are not located within the United States and only effect trades in, or advise on, futures on or subject to the rules of non-U.S. commodity exchanges or boards of trade. The Rule 30.5 exemption would not be available to non-US fund managers that effect trades of futures or options on futures contracts on or subject to the rules of a U.S. exchange; however, non-US managers may utilize a self-executing exemption from registration as a CTA or CPO under Rule 3.10(c)(3)(i) if, among other things, its commodity interest transactions are cleared through a futures commission merchant registered under the CEA. To claim the Rule 30.5 exemption, the non-US fund manager would need to file with the NFA a form that appoints the NFA as agent for service of process in the U.S.

### **Exemptions Available to Commodity Trading Advisers**

A CTA is defined as any person who for compensation or profit, engages in the business of advising others as to the value of or the advisability of trading in futures and commodity options and the futures market.<sup>10</sup> In the fund context, a CTA is typically the investment manager to the fund. Unless otherwise exempt, CTAs are required to register with the CFTC and become a member of the NFA, distribute disclosure documents to prospective clients, implement compliance policies and procedures and maintain their books and records in accordance with NFA rules.

Many fund managers that have relied on the sophisticated investor exemption have also relied on the Rule 4.14(a)(8) exemption to avoid registration as a CTA. Rule 4.14(a)(8) allows advisers registered under the Advisers Act or under state securities laws, or advisers that

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<sup>7</sup> A broad-based security index means an index that has ten or more component securities, or that otherwise does not meet the criteria for a narrow-based security index. A narrow-based security index must have nine or fewer component securities and meet certain other requirements.

<sup>8</sup> See FN. 4 herein.

<sup>9</sup> See NFA Notice I-12-10 “Guidance to Members Carrying Accounts for, or Transacting Business with Persons Exempt from Registration” (June 25, 2012), available at <http://www.nfa.futures.org/news/newsNotice.asp?ArticleID=4055>.

<sup>10</sup> 7 U.S.C. § 1A(6).

are exempt from registration as an investment adviser under such laws or advisers excluded from the definition of investment adviser, to qualify for the exemption from registration as a CTA, provided that the advice furnished is directed (1) exclusively toward qualifying entities under Rule 4.5 for which a notice of eligibility has been filed, (2) collective investment vehicles that are excluded from the definition of commodity pool under Rule 4.5(a)(4) or (3) commodity pools that are organized and operated outside of the United States. Additionally, Rule 4.14(a)(8)(D) allows a CTA to avail itself of an exemption from CTA registration in the event that advice is being provided to “a CPO who has claimed an exemption under Rule 4.13(a)(3) or Rule 4.13(a)(4) or, if registered as a CPO, who treats each pool it operates under those exemptions as if it were not registered.”<sup>11</sup> After December 31, 2012, however, in order for a CTA to remain exempt from registration pursuant to Rule 4.14(a)(8)(D), the pool being advised must have filed an exemption from registration under Rule 4.13(a)(3) or another exemption.<sup>12</sup> Additionally, the commodity interest advice provided by the CTA must be solely incidental to the business of providing securities advice or other investment guidance. Further, the CTA seeking exemption under Rule 4.14(a)(8) must not hold itself out as a CTA. In order to qualify for an exemption under Rule 4.14(a)(8), the CTA must file a notice of exemption with the NFA no later than at the time the advisory agreement is presented to the client. In addition to identifying the CTA, the notice must state the Rule 4.14(a)(8) exemption being claimed and that the advice furnished by the exempted party complies with the requirements set forth under the exemption.<sup>13</sup> The Final Rules require fund managers to confirm their CTA exemption on an annual basis (otherwise, the CTA must withdraw the exemption) within 60 days of calendar year end. The effective compliance date for this new requirement is no later than December 31, 2012.

Fund managers that cannot qualify under the *de minimis* exemption from registration as a CPO may still nonetheless avail themselves of other CTA exemptions.

Section 4m(3) of the CEA exempts advisers who are SEC-registered investment advisers, provided that the adviser’s business does not primarily consist of acting as a CTA and such adviser does not act as a CTA to any commodity pool that is engaged primarily in trading commodity interests. In addition, Section 4m(1) and its corresponding Rule 4.14(a)(10) provide an exemption to CTAs (applicable to both registered and exempt investment advisers) who, during the previous 12 months, have not provided investment advice to more than 15 clients and who do not hold themselves out generally to the public as a CTA.<sup>14</sup> For purposes of counting clients, the CFTC counts each commodity pool as one client similar to the old investment adviser regime that preceded the Dodd-Frank Act. Each of the foregoing exemptions are self-executing, and consequently, does not require a notice filing with the NFA.

As a practical matter, the Final Rules do not change the status quo with respect to registration as a CTA. Fund managers that are not engaged primarily in trading commodity interests will continue to be able to rely on existing exemptions. With respect to CPO regulation, the rescission of the Rule 4.13(a)(4) exemption will likely cause an influx of registrations prior to December 31, 2012 (the date the Rule 4.13(a)(4) exemption will terminate for existing CPOs that filed a notice of exemption prior to April 24, 2012). In addition, the recent passage of the CFTC final rule further defining swaps will likely trigger additional registrations in the near term for new fund managers that trade swaps.

## The CPO Registration Process

Registration with the NFA requires that, among other things, a CPO:

- becomes a member of the NFA and pays annual dues of \$750 per year; and
- Files an application on Form 7-R and pays a \$200 applicable fee.

Form 7-R requires fund managers to provide basic identification and contact information as well as to disclose any regulatory, disciplinary or criminal actions taken against the fund manager. The information to be disclosed on Form 7-R is available to the public. Any changes to information included on Form 7-R must be promptly reported to the NFA through submission of Form 3-R. As a condition of registration, fund managers are required to complete an online review of registration information filed with the NFA on an annual basis. Failure to file this review within 30 days of the established deadline will be considered a request for withdrawal from registration with the NFA.

Similar to registered investment advisers, as part of the registration process, CPOs are also required to design and implement compliance policies and procedures to comply with CFTC and NFA rules, including the disclosure, reporting and recordkeeping requirements of Part 4 of the CFTC rules. A firm’s compliance manual should include sections on, among other things, ethics, annual compliance reviews, employee registrations as associated persons and disaster recovery planning. SEC registered investment advisers should review their compliance manuals to ensure all CPO related policies and procedures are incorporated into their existing compliance manuals.

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<sup>11</sup> CFTC Rule 4.14(a)(8)(D).

<sup>12</sup> See FN. 9 herein.

<sup>13</sup> 17 C.F.R. § 4.14(a)(8).

<sup>14</sup> 7 U.S.C. § 6m(1).

Certain employees or beneficial owners of a CPO<sup>15</sup> are also subject to regulation and may have to register as either a “principal” or “associated person” or both. A “**principal**” is defined as (1) the general partner where the CPO is organized as a partnership; (2) a director, president, chief executive officer, chief operating officer, chief financial officer, and any person in charge of a principal business unit, division or function subject to regulation by the CFTC where the entity is a corporation or a limited liability company; (3) the manager, managing member or members vested with management authority in the case of a limited liability company; and (4) any person occupying a similar status or performing a similar function in the entity. A principal also includes (i) any individual who, directly or indirectly, is the owner of 10% or more of the outstanding shares of any class of stock, is entitled to vote or has the power to sell or direct the sale of 10% or more of any class of voting securities, or is entitled to receive 10% or more of the profits of the CPO; (ii) an entity that is the direct owner of 10% or more of any class of securities; or (iii) any person who has contributed 10% or more of the capital of the CPO.<sup>16</sup> A principal may be determined by his or her ability to control the entity’s business activities, regardless of formal title or position or financial interest in the entity or alternatively based on his or her title, regardless of ability to control the entity’s business. All principals must be listed on the Form 7-R.

An “associated person” of a CPO will also be subject to registration under the CEA. An “**associated person**” is defined as a partner, officer, employee, consultant or agent (or any natural person performing similar functions), in any capacity which involves (1) the solicitation of funds, securities, or property for participation in a commodity pool or (2) the supervision of any person or persons so engaged. An associated person also includes individuals involved in (i) the solicitation of a client’s or prospective client’s discretionary account, or (ii) the supervision of any person or persons so engaged.<sup>17</sup> Fund managers should be aware that at least one principal must be registered as an associated person of the CPO. NFA Bylaw 301(a)(iii) states that “no person, unless eligible for membership in the contract market category, shall be eligible to become or remain a Member unless at least one of its principals is registered as an ‘associated person’ under the CEA and CFTC Rules. If any Member fails to have at least one principal that is registered as an ‘associated person,’ the NFA shall deem that Member’s failure to be a request to withdraw from NFA membership and shall notify that Member accordingly.”

All principals and associated persons are required to submit a Form 8-R, an individual application regarding certain background information on the associated person or principal, along with fingerprint cards to the NFA as part of the application and registration process. Non-exempt associated persons are also required to pass the Series 3 examination administered by the Financial Industry Regulatory Authority, Inc. (“**FINRA**”) within two years prior to completing the application. The NFA may waive the examination requirement in certain limited circumstances.

Relief from registration is available for principals and associated persons meeting certain requirements. Exemptions are available for an individual who is registered with FINRA as a registered representative, registered principal, limited representative or limited principal, provided that individual does not engage in any other activity subject to CFTC regulation. Further, with respect to associated persons, relief is available to the chief operating officer, general partner or other person in the supervisory chain-of-command, provided, however, that the CPO or CTA engages in commodity interest-related activity for customers, but such activity constitutes no more than 10% of its total revenue on an annual basis and such individual does not engage in any solicitation of fund interests or have any direct supervisory or related authority over persons so engaged.<sup>18</sup> Accordingly, non-exempt associated persons must take the Series 3 examination.

#### **CFTC Rule 4.7 – Registration Lite**

Rule 4.7 remains an important option for CPOs seeking to reduce the burden of compliance with NFA disclosure, reporting and recordkeeping requirements. CPOs qualifying for the Rule 4.7 exemption or “*Registration Lite*,” are entitled to relief from certain substantive requirements of the CEA set forth in Rules 4.31, 4.34, 4.35 and 4.36.<sup>19</sup> In order to qualify for the exemption, the CPO must comply with the following conditions: (1) interests in each commodity pool must be sold exclusively to QEPs; (2) offers and sales of the securities of the commodity pool must qualify from exemption under Section 4(2) of the Securities Act or Regulation S thereunder; and (3) a notice of exemption must be filed with the NFA prior to an offer or sale of interests in the commodity pool. In addition, a CPO relying on the Rule 4.7 exemption must include a legend in its offering memorandum or subscription agreement prominently displayed on the cover page of the offering memorandum or subscription agreement. The legend must state, in part, that the pool’s participants are limited to QEPs and that an offering memorandum is not required to be and has not been filed with the CFTC.<sup>20</sup>

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<sup>15</sup> For example, in a typical domestic hedge fund structure, the CPO would be the general partner, typically organized as a limited liability company, and the employees and certain beneficial owners of the general partner entity would be required to register as a principal or associated person or both.

<sup>16</sup> 17 C.F.R. § 3.1(a)(1)-(3).

<sup>17</sup> 17 C.F.R. § 1.3(aa).

<sup>18</sup> 17 C.F.R. § 3.12(h).

<sup>19</sup> 17 C.F.R. § 4.7(c). There are other registration exemptions available. CFTC Advisory 18-96 provides relief for certain registered CPOs from the CFTC disclosure, reporting and recordkeeping requirements, provided the commodity pool is organized and operated outside the United States and there are no U.S. person shareholders participating in the commodity pool. Rule 4.12(b) exemption is also available, but it has limitations on margin and premiums and has significantly more disclosure, reporting and other requirements as compared to the Rule 4.7 exemption.

<sup>20</sup> 17 C.F.R. § 4.7(b)(1).

A registered CPO claiming relief under Rule 4.7 also must comply with various reporting requirements. Rule 4.7(b)(2) requires CPOs to distribute to pool participants quarterly reports on, among other things, the change in net asset value (“NAV”) of the commodity pool within 30 calendar days of the end of the reporting period. Additionally, Rule 2-46<sup>21</sup> requires each registered CPO to file electronically with the NFA a report on a quarterly basis with specific information on certain pools that it operates within 45 days after the end of each quarterly reporting period. The report requires information on various service providers to the commodity pool, quarterly performance information and a statement of change in NAV and a schedule of investments identifying any investment that exceeds 10% of such pool’s NAV for the quarter. In addition, within 90 days of fiscal year end, CPOs must file electronically with the NFA<sup>22</sup> and distribute to pool participants, audited annual reports which include a 4.7 legend. Fund managers should pay particular attention to the accelerated delivery requirement for audited financial statements, which is 30 days earlier than under the custody rule applicable to an SEC registered investment adviser (*i.e.*, 120 days). However, under Rule 4.22(f), a CPO may seek an extension for the annual report filing from the NFA up to 180 days from fiscal year end. CPOs that are SEC-registered investment advisers should nonetheless consider modifying their offering documents upon claiming the Rule 4.7 exemption to reflect the accelerated delivery date. In addition, the NFA requires NFA members (including members who take advantage of the Rule 4.7 exemption) to review on a yearly basis self-audit questionnaires that can be downloaded from the NFA’s website. Finally, as discussed below in greater detail, the CFTC adopted Rule 4.27 (which became effective July 2, 2012) requiring registered CPOs to provide certain information to the CFTC on Form CPO-PQR.

### **Requirements and thresholds for Form CPO-PQR**

Form CPO-PQR is comprised of three schedules with different disclosure requirements depending on the CPO’s assets under management. Form CPO-PQR requires disclosure on, among other things, the amount of assets under management, key personnel, creditors, borrowings, counterparty credit risk exposure and trading and investment positions. Schedule A requires CPOs to provide basic identifying information about the CPO, assets under management, certain service providers, rates of return and subscription and redemption activity. Schedule A must be completed and filed by any CPO that satisfies the definition of CPO and operates at least one commodity pool during a given reporting period. Schedule B requests detailed information about commodity pools managed by mid-sized CPOs<sup>23</sup> and large CPOs<sup>24</sup>. Schedule C requests additional pool information managed by large CPOs. Smaller CPOs must file Schedule A annually (within 90 days of year end), mid-sized CPOs must file Schedules A and B annually (within 90 days of year end) and large CPOs must file Schedules A, B and C quarterly (within 60 days of quarter end). Fund managers should note that the CFTC is mandated by the Dodd-Frank Act to keep the information it collects on Form CPO-PQR confidential.

Investment advisers that are dually registered with the SEC and CFTC will be able to rely on the filing of Form PF in lieu of filing certain schedules of Form CPO-PQR, which will be deemed a filing with both agencies. However, all private fund advisers that are registered CPOs will still be required to file Schedule A of Form CPO-PQR and Schedules B and C if the CPO manages pools that do not qualify as “private funds” as defined under the Advisers Act.

The compliance dates for reporting on Form CPO-PQR are as follows: 60 days after the end of the CPO’s first calendar quarter ending after July 2, 2012 for CPOs having at least \$5.0 billion in assets under management; 60 days after the end of the CPO’s first calendar quarter ending after December 14, 2012 for all other CPOs with assets of \$1.5 billion or more; and 90 days after calendar year end 2012 for all other CPOs.

### **Penalties for Non-Compliance with CFTC Rules and the NFA Bylaws**

CPOs that are currently relying on the Rule 4.13(a)(4) exemption will need to pre-file before December 31, 2012 with the NFA to qualify for another exemption. CPOs utilizing the pre-filing option will not become subject to the additional reporting and disclosure requirements associated with the newly claimed exemption until January 1, 2013. Under recent guidance from the CFTC, fund managers should avoid withdrawing the Rule 4.13(a)(4) exemption unless a new exemption has been pre-filed, otherwise the CPO will become subject to the full panoply of regulation for a registered CPO, including the requirement to file a certified annual report for 2012.<sup>25</sup> CPOs that must register are not required to affirmatively withdraw their existing exemption as the NFA will automatically withdraw the exemption on December 31. It should also be noted that the pre-file option is available for registered CPOs seeking to avail themselves of the Rule 4.7 exemption.

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<sup>21</sup> For more information, see NFA Notice to Members I-10-10 “Effective Date of NFA Compliance Rule 2-46: CPO Quarterly Reporting Requirements” (March 17, 2010), available at <http://www.nfa.futures.org/news/newsNotice.asp?ArticleID=2457>.

<sup>22</sup> It is important to note that the annual reports are kept confidential by the NFA.

<sup>23</sup> A mid-sized CPO is defined as any CPO that had at least \$150 million in aggregated pool assets under management as of the close of business on any day during a “reporting period.” For a mid-sized CPO, the reporting period is the calendar year.

<sup>24</sup> A large CPO is defined as 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 a reporting period. A reporting period for a large CPO is any individual calendar quarter.

<sup>25</sup> See Notice to Members I-12-09 “Guidance to NFA Member CPOs and CTAs that Operate or Advise Pools Pursuant to an Exemption under CFTC Regulation 4.13(a)(4)” (June 22, 2012), available at <http://www.nfa.futures.org/news/newsNotice.asp?ArticleID=4054>.

Fund managers need to pay particular attention to the annual CPO exemption filing requirements; failure to comply could have dire consequences. After December 31, 2012, any NFA member that carries an account or transacts business with an exempt CPO or a registered CPO claiming exemptive relief under Rule 4.7 must ensure that such CPO properly files the notice reaffirming the exemption in order to continue to conduct business with the CPO. The same requirement applies to CTAs claiming exemption under Rule 4.14(a)(8). Failure to take these steps could expose NFA members, including their counterparties (e.g., prime brokers who are registered CTAs and/or CPOs) to violations of NFA Bylaw 1101 and/or NFA Compliance Rule 2-36(d).<sup>26</sup>

Non-compliance with NFA rules exposes the CPO or CTA in question to penalties under Rule 3-14 of the NFA Manual. Potential penalties include the following: expulsion or suspension for a specified period from NFA membership, bar or suspension for a specified period from association with an NFA member, censure or reprimand, a monetary fine not to exceed \$250,000 per violation, order to cease and desist and any other penalty or remedial action not inconsistent with Rule 3-14. The net effect of such violations is a complete ban from acting as a CPO in respect of any commodity pool.

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<sup>26</sup> See FN. 9 herein.