

## INSIGHTS

## CFTC Regulation of Hedge Funds to Increase - Final Rules Adopted

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On February 9, 2012, the Commodity Futures Trading Commission (CFTC) issued final rules rescinding and revising certain key exemptions to its registration requirements that have been routinely relied upon by the advisors and sponsors of private funds and investment companies registered under the Investment Company Act of 1940 (Final Rules). Under the Final Rules, a hedge fund or hedge fund advisor who previously was exempt from the CFTC's registration requirements may now need to register as a commodity pool operator (CPO) or a commodity trading advisor (CTA). Even for those who remain exempt, the Final Rules impose a new annual notice requirement to qualify for the exemption. The Final Rules will become effective 60 days after their publication in the Federal Register with delayed compliance deadlines as discussed herein.

### **Rescission of Rule 4.13(a)(4)**

The Final Rules rescind Rule 4.13(a)(4), an exemption relied upon by funds whose investors are "qualified eligible persons" or "accredited investors" as defined in Section 230.501(a)(1)-(3), (a)(7), and (a)(8) of the Securities Exchange Commission's (SEC) regulations (e.g., certain banks, private business development companies, and 501(c)(3) organizations or trusts with assets in excess of \$5,000,000). Existing funds that currently rely on Rule 4.13(a)(4) have been grandfathered until December 31, 2012. After that time, unless another exemption applies, such funds will be required to register as CPOs. Rule 4.13(a)(4) will not be available to new funds once the Final Rules are in effect (60 days from the date of publication in the Federal Register).

### **Revision of Rule 4.13(a)(3)**

The CFTC initially proposed to also rescind Rule 4.13(a)(3), which applies to funds that trade only a *de minimis* level of commodity interests and which are not marketed as vehicles for trading in commodity interests. However, in response to comments opposing the proposed change, the CFTC elected to retain the exemption but modify how the "notional value" of futures, options, and swaps is to be calculated for purposes of applying the *de minimis* threshold. In addition, funds relying on this exemption must now provide an annual notice with the National Futures Association (NFA) within 60 days of each calendar year.

### **Rule 4.5 Exclusion**

In addition to rescinding Rule 4.13(a)(4) and modifying Rule 4.13(a)(3), the Final Rules modify the exclusion from the definition of CPO for investment advisers to investment companies

registered under the Investment Company Act. Under the Final Rules, Rule 4.5 imposes trading thresholds and marketing restrictions on investment advisers to registered investment companies who take advantage of the exclusion. Compliance with this change will be required upon the later of December 31, 2012, or 60 days after the effective date for the final rule defining the term “swap.” Here again, funds relying on this exclusion must now provide an annual notice with the NFA within 60 days of each calendar year.

### **Changes to CPO/CTA Requirements**

In addition to the rescission of Rule 4.13(a)(4) and changes to Rules 4.13(a)(3) and 4.5, the Final Rules also modified certain requirements applicable to CPOs and CTAs. For example, the CFTC will no longer exempt CPOs whose participants are “qualified eligible persons” from providing audited financial statements, and CPOs and CTAs will be required to file additional reports with the NFA and disclosures to their participants and customers.

### **Conclusion**

Funds and advisors not currently registered as CPOs or CTAs should re-evaluate their eligibility for exemption from the CFTC’s registration requirements in light of the Final Rules. Even if they remain exempt, it may be necessary to change representations related to such exemptions, and it will be necessary to comply with new notice requirements. For funds or advisors who are registered or will need to register as CPOs or CTAs, it will be important to consider the impact of the Final Rules on the related requirements.