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**Sent:** Thursday, July 07, 2011 12:15 PM  
**To:** fundlaw@yahoogroups.com  
**Subject:** [FundLaw] CFTC Staff Roundtable

On July 6, 2011, the Commodity Futures Trading Commission staff ("CFTC") hosted a roundtable to discuss the proposed changes to the registration and compliance regime for commodity pool operators ("CPOs") and commodity trading advisors ("CTAs"). The proposed changes by the CFTC include: (i) reinstatement of limitations that were repealed by the CFTC in 2003 on the marketing and trading activities of registered investment companies ("RICs") (currently exempt through CFTC Regulation 4.5); (ii) rescission of the existing exemptions from CPO registration pursuant to CFTC Regulations 4.13(a)(3) and 4.13(a)(4); and (iii) implementation of periodic reporting requirements for all registered CPOs and CTAs with respect to any funds and other pools that they operate.   
  
Below is a summary of the more significant items that were noted at the roundtable.   
  
Generally, the participants of the roundtable representing RIC interests stressed that if dual registration with the CFTC and Securities and Exchange Commission ("SEC") is required, it will create significant compliance burdens and costs for funds, especially for smaller funds, and their shareholders and is otherwise unnecessary and burdensome. The participants representing the commodity interests believed that activities resulting from investments in commodities should nevertheless be regulated by the CFTC, even if these funds are already regulated by the SEC. It may be important to note, however, that the Chamber of Commerce stated that the proposed changes are much too broad, adequate consideration was not given with regard to the proposals, and the proposed amendments to Regulation 4.5 should be withdrawn and re-proposed after Dodd-Frank Title VII rulemaking is complete. Most of the participants (including the National Futures Association ("NFA")) were generally critical of the proposals.  
  
It is unclear how the CFTC will approach revising the proposed rules. There was discussion of the possibility of (i) adopting the proposed rules with significant changes; (ii) re-proposing the rules based on comment letters and discussions; or (iii) gathering industry data (through possibly revisions to the 4.5 notice exclusion) and then re-proposing the rules based on such data. The CFTC expressly acknowledged that harmonization with SEC rules, especially with regard to disclosure, recordkeeping, and reporting requirements, is required before implementation of a dual registration system (by way of comparison, it was noted that it has taken the CFTC almost two years to harmonize certain forms with the SEC). The comment period for inclusion into the record will be open for another two weeks.   
  
Changes to 4.5  
  
There was discussion of amending the proposed rule to exempt funds that only utilize certain derivatives that are tied to a particular index and exempting all funds except those that hold themselves out as a "managed futures vehicle." It was agreed by the participants that exempting only funds that utilize derivatives for bona fide hedging purposes was not sufficiently broad and there was some discussion that utilizing a notional value percentage test would not be effective. The NFA also indicated that funds should not have to register just because their marketing products advertise some exposure to commodities (although the NFA argued that the CFTC should adopt the 5% threshold test for non-hedging positions as the first test, and then an analysis of the marketing as the second test). The theme of the discussion was that the CFTC should consider which funds it wants to regulate and then propose rules that will capture these types of funds, and not vice versa.   
  
The CFTC appeared open to all of these ideas. Based on the discussion, it seems unlikely that proposed changes to Regulation 4.5 will be adopted without significant changes that will accommodate an exemption for a certain percentage of funds that currently rely on Regulation 4.5 and are not actively and significantly trading in futures or swaps.   
  
Who Should Register as a CPO?  
  
Participants (including the NFA) agreed that the adviser and not the fund should register as a CPO. It was discussed that having the fund register as a CPO would be a disincentive for trustees to serve on boards and would open them to greater liability under the Commodities Exchange Act, as opposed to the protection they currently enjoy under the business judgment rule. There would be no real benefit to the CFTC to have funds register as CPOs instead of advisers, and it may in fact overwhelm the CFTC with additional filings, and subject trustees to exams which do not serve a public policy reason.   
  
Again, the CFTC appeared open to this discussion.   
  
Disclosure Harmonization  
  
The SEC indicated that it would allow CFTC proposed calculations for any underlying funds (i.e., Cayman subsidiaries) to be included in the Acquired Fund Fees and Expenses line item of Form N-1A.   
  
Some participants cautioned against allowing a separate CFTC document to be delivered with a fund prospectus, and others argued that it would be better for investors to include SEC and CFTC disclosure in the prospectus. The SEC acknowledged they would have to amend the summary prospectus rules for CFTC materials. The SEC and CFTC would have to work together to harmonize fees (the CFTC has a break-even table while the SEC has the example table).  
  
The CFTC indicated that they would review the fee tables to see what it would take to make them harmonized.   
  
Monthly Reporting Requirement  
  
Participants argued that providing a monthly report to shareholders would be expensive and of limited value. RIC participants again discussed the actual value added to the shareholder in providing such reports.   
  
The CFTC took particular note of the large costs to shareholders to produce monthly reports, even if they were only disseminated via a webpage or other regulatory filing.   
  
Controlled Foreign Corporations  
  
The RIC participants stressed that the major, if not the only, factor for a controlled foreign corporation's (e.g., Cayman subsidiaries) existence is to convert bad income into good income for tax purposes. The two funds should be thought of as the same. There are no devious purposes, as stated by the participants, in allowing this, and it has been sanctioned by the SEC and IRS.   
  
Most of the discussion dealt with disclosure. The NFA argued that the 25% commodity portion of the fund is typically driving the performance of the fund (and the remaining 75% is usually fixed income). Therefore, more significant disclosure should be required , especially with regard to strategy and leverage. The Investment Company Institute and others argued that disclosure of the controlled foreign corporation is mostly a side issue, as any of the risks of the controlled foreign corporation are risks of the funds themselves. A discussion ensued about the validity of the recent Wall Street Journal article that brought attention to controlled foreign corporations.  
  
The CFTC indicated that it would need to have more dialogue with the IRS and knowledge as to the conditions of the IRS private letter rulings.   
  
Regulation 4.13 (a)(3) and (a)(4)  
  
Various participants argued against rescission of the 4.13(a)(3) and  
(a)(4) exemptions from registration with respect to certain commodity pools whose investors are limited to accredited investors or qualified eligible persons. Up to 6,000 additional funds may be subject to CFTC regulations if the CFTC decides to rescind the regulation. Regardless, the participants felt that if the CFTC were going to rescind these provisions of Regulation 4.13, it would need to make sure that funds operate under one regulatory framework. Again, participants stressed that the CFTC should decide which entities it wants to regulate first, and then propose such rules afterwards to capture these entities.   
  
The CFTC requested that participants provide a line-by-line analysis of exactly which rules need to be harmonized to ensure the CFTC and SEC are operating under one regulatory framework.   
  
The press release for the roundtable, as well as links to other related items, may be found here:  
  
<http://www.cftc.gov/PressRoom/PressReleases/pr6060-11.html>  
  
The most recent FundLaw post on the subject is at  
  
<http://groups.yahoo.com/group/FundLaw/message/1317>  
  
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