NFA Compliance Rule 2-50: New Event Notice Filings for Registered CPOs

April 7, 2021

On March 5, 2021, the National Futures Association (the "NFA") submitted proposed new NFA Compliance Rule 2-50 (the "Rule") and an accompanying Interpretive Notice to the Commodity Futures Trading Commission (the "CFTC"). The Rule will require commodity pool operators that are registered with the CFTC (and therefore members of the NFA) ("CPO Members") to notify the NFA promptly upon the occurrence of certain events affecting a commodity pool operated by the CPO Member, including the inability to meet margin calls or satisfy redemption requests, the halting or suspension of redemptions, or a declaration of default under a swap agreement.

The NFA plans to issue an additional notice to members setting an effective date for the Rule following the expiration of the ten-day period from such submission, although no effective date has been established as of the date of this Update.

EVENTS REQUIRING NOTIFICATION

The Rule will require each CPO Member to notify the NFA upon the occurrence of any of the following events:

- *Inability to Meet Margin Call(s)*: The CPO Member operates a commodity pool that is unable to meet one or more margin calls.

  The CPO Member is not required to file notification on the day the pool receives the margin call if the CPO Member reasonably expects to meet the margin call within the prescribed time period. However, once the CPO Member determines that a pool will be unable to meet a margin call, including in situations where the amount or appropriateness of the margin call is disputed by the CPO Member, it must file the required notice with the NFA.

- *Inability to Satisfy Redemption Requests*: The CPO Member operates a commodity pool that is unable to satisfy redemption requests in accordance with its subscription agreements.

If the CPO Member is able to meet a redemption request in accordance with the terms of the applicable subscription agreement (*e.g.*, taking into account any grace period, permitted in-kind redemption payments, or side pocket provisions), no notice to the NFA is required. However, once the CPO Member determines that a pool will not be able to meet a redemption request in accordance with the terms of the subscription agreement, it must file the required notice with the NFA.

- *Halt or Suspension of Redemptions*: The CPO Member operates a commodity pool that has halted or suspended redemptions and such halt or suspension is not associated with pre-existing gates or lockups, or a pre-planned cessation of operations.

  A CPO Member is not required to notify the NFA if it halts or suspends redemptions in accordance with pool subscription agreements following a decision to liquidate the pool in the ordinary course of business and until a final accounting can occur. Notification is also not required in connection with the imposition of pre-determined gates or lockups pursuant to pool subscription agreements. However, when a pool unexpectedly permanently or temporarily halts or suspends redemptions as a result of a market or other event that impacts the pool's ability to meet redemptions, the CPO Member must file the required notice with the NFA. Although not specifically addressed by the NFA, typical examples of such market events would include, among others, market closures, communication breakdowns that impact the price or value of pool assets, interruptions to fund remittance services and other similar events that substantially impact liquidity or value of the pool's assets.

- *Default under Swap Agreement*: The CPO Member receives notice from a swap counterparty that a pool the CPO Member operates is in default.

  The NFA requires a CPO Member to file notice with the NFA if the CPO Member is notified by a swap counterparty that the pool is in default if the CPO Member does not reasonably believe the pool can cure the default within a previously agreed cure period. This requirement applies even if the pool disputes the default notice or is in negotiations with the swap counterparty to liquidate positions.

The notification to the NFA is required to be made promptly, and no later than 5:00 pm (CT) of the next business day following the relevant event.

It is important to note that the Rule will apply not just to commodity pools operated on a registered basis, but also to commodity pools that are operated by a CPO Member on an exempt basis (*e.g.*, a commodity pool operated by a CPO Member as if exempt under the CFTC regulation 4.13(a)(3) *de minimis* exemption).

BASIS FOR THE RULE

In the Interpretive Notice, the NFA indicates that the Rule is designed to ensure that CPO Members provide timely notification to the NFA of potential financial issues that may impact the CPO Member's ability to fulfill its obligations or that may result in a pool's unplanned liquidation. The NFA indicates that notifications pursuant to the Rule will assist the NFA in readily identifying CPO Members with pools that have been adversely impacted by a market or other event.

The NFA notes that CPO Members are currently required to report some of these events in a quarterly Form PQR filing or in a pool annual report. However, the NFA believes that such periodic reporting does not provide it with timely information about critical events that impact CPO Members and their pool participants.

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Please do not hesitate to contact us with any questions.

NEW YORK

Byungkwon Lim
blim@debevoise.com

Gary E. Murphy
gemurphy@debevoise.com