PROPOSED AMENDMENTS TO REGULATIONS ON COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

February 2, 2011

To Our Clients and Friends:

The Commodity Futures Trading Commission (the "Commission") has proposed to amend Part 4 of the Regulations under the Commodity Exchange Act (the "CEA") regarding commodity pool operators ("CPOs") and commodity trading advisors ("CTAs").[1]

The proposed amendments would: (i) repeal the exemptions from registration of CPOs provided in Sections 4.13(a)(3) and 4.13(a)(4); (ii) modify the criteria for registered investment companies claiming relief under Section 4.5; (iii) repeal relief from the certification requirement for annual reports provided to operators of certain commodity pools under Section 4.7; (iv) incorporate the revised definition promulgated by the Securities and Exchange Commission (the "SEC") of "accredited investor" under Section 4.7; (v) require the annual filing of a notice claiming exemptive relief with the National Futures Association (the "NFA") under Sections 4.5, 4.13 and 4.14; (vi) require the filing with the NFA of Forms CPO-PQR and CTA-PR pursuant to proposed Section 4.27; and (vii) require the inclusion of new risk disclosure requirements for CPOs and CTAs regarding swap transactions under Sections 4.24 and 4.34.

In the notice of proposed rulemaking, the Commission stated that the proposed amendments are intended to allow the Commission to more effectively oversee market participants that it regulates and to manage the risks that such participants pose to the markets as part of its mandate under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") to adequately oversee the commodities and derivatives markets and assess market risk associated with pooled investment vehicles under the Commission's jurisdiction.

REPEAL OF EXEMPTIONS UNDER SECTIONS 4.13(a)(3) AND 4.13(a)(4)

A pooled investment vehicle is a commodity pool under the CEA if it trades or invests in, among other instruments, futures contracts. The Dodd-Frank Act amended the definition of commodity pool to include a pooled investment vehicle that trades or invests in swaps (as

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[1] *The full text of the Commission's release and rules can be found at http://www.cftc.gov/PressRoom/Events/opaevent_doddfrank012611.html.*

defined in Section 721 of the Dodd-Frank Act). This amendment will become effective as of July 16, 2011.

A sponsor or operator of a commodity pool (such as the general partner of a private fund) is required to register with the Commission as a CPO, and an investment advisor to a commodity pool is required to register with the Commission as a CTA, unless, in either case, an exemption is available under the CEA or the regulations of the Commission. The Commission has proposed to repeal the exemptions from registration of CPOs provided in Sections 4.13(a)(3) and 4.13(a)(4), which CPOs of private funds have most frequently relied on. The Commission noted its belief that operators of these pools should be subject to similar regulatory obligations as investment advisors to private funds.

Section 4.13(a)(3) is typically available in the case of private funds that rely on Section 3(c)(1) of the Investment Company Act of 1940 (the "Investment Company Act") for exemption from registration under the Investment Company Act. Section 4.13(a)(3) generally provides for exemption from CPO registration if the interests in the commodity pool are exempt from registration under the Securities Act of 1933 (the "Securities Act") and are offered only to qualified eligible participants ("QEPs") (which include qualified purchasers as defined under the Investment Company Act), accredited investors or knowledgeable employees, and the commodity pool's aggregate initial margin and premiums attributable to commodity interests do not exceed five percent of the liquidation value of the commodity pool's portfolio.

Section 4.13(a)(4) is typically available in the case of private funds that rely on Section 3(c)(7) of the Investment Company Act for exemption from registration under the Investment Company Act. Section 4.13(a)(4) generally provides for exemption from CPO registration if the interests in the commodity pool are exempt from registration under the Securities Act and the operator reasonably believes that the participants in the commodity pool are QEPs.

Pursuant to the proposed repeal, CPOs that currently rely on either Section 4.13(a)(3) or 4.13(a)(4) would be required to register with the Commission and would be subject to various disclosure, reporting and recordkeeping requirements. However, registered CPOs may continue to rely on Section 4.7 (as amended pursuant to this proposed rulemaking) for partial relief from certain disclosure and periodic reporting requirements, provided that the commodity pool is offered only to QEPs.

As a result of the proposed repeal of Sections 4.13(a)(3) and 4.13(a)(4), CTAs would not be able to rely on Section 4.14(a)(8)(i)(D) for exemption from registration. The Commission has not proposed a similar repeal of other exemptions available to CPOs and CTAs, including exemptions available under Section 4m(1) of the CEA and Sections 4.14(a)(8) and 4.14(a)(10).

The Commission has asked for comments regarding the possibility of grandfathering CPOs that have previously claimed exemptions under Sections 4.13(a)(3) and 4.13(a)(4) from compliance with the proposed revisions.

MODIFICATION OF RELIEF CRITERIA UNDER SECTION 4.5

Currently, Section 4.5 provides an exclusion from the definition of a CPO to certain regulated persons, including investment companies registered under the Investment Company Act. Specifically, there are currently no restrictions on the amount of commodity interest trading (*i.e.*, the amount of futures transactions and, on and after July 16, 2011, the amount of swap transactions, that can be entered into by registered investment companies) or marketing of interests in registered investment companies.

The Commission has proposed to amend Section 4.5 as it applies to investment companies registered under the Investment Company Act. A registered investment company would be required to file a notice of eligibility with the Commission, which contains representations, among other things, that (i) the use of commodity futures, commodity options and swaps, other than for bona fide hedging purposes, will be limited to five percent of the liquidation value of the investment company's portfolio, and (ii) participations in the investment company will not be marketed as interests in a commodity pool to the public.

REPEAL OF EXEMPTIVE RELIEF FROM CERTIFICATION REQUIREMENT UNDER SECTION 4.7

Currently, financial statements contained in annual reports distributed to pool participants and filed with the NFA are not required to be certified by an independent auditor under Section 4.7(b)(3)(i). However, the Commission has proposed to extend the requirement for certified financial statements in commodity pool annual reports to commodity pools with participants who are QEPs for the purpose of ensuring the accuracy of the financial information. Commission staff would continue to consider requests for exemption from the audit requirement pursuant to the general exemptive provisions of Section 4.12(a).

INCORPORATION OF ACCREDITED INVESTOR DEFINITION UNDER SECTION 4.7

The Commission has proposed to amend Sections 4.7(a)(3)(ix) and (a)(3)(x), which include an outdated definition of "accredited investor" within the definition of "QEP". The proposal would incorporate the SEC's new definition of "accredited investor" by reference to Regulation D under the Securities Act.

ANNUAL FILING OF CLAIMS OF EXEMPTION UNDER SECTIONS 4.5, 4.13 AND 4.14

Currently, persons claiming exemptive relief from inclusion in the definition of a CPO or from registration as a CPO or CTA under Section 4.5, 4.13 or 4.14 are required to file only a single notice of such claim with the NFA and to comply with a few minor requirements. Such persons are not required to notify the NFA if they cease operating as a going concern.

The Commission has proposed to require all persons claiming relief under Section 4.5, 4.13 or 4.14 to confirm their notice of claim of exemption or exclusion on an annual basis. Alternatively, a person may withdraw the certification (if due to other than the cessation of activities requiring registration or exemption therefrom) and file a registration application with the NFA within 30 days of the anniversary date of the initial claim for exemptive relief. Failure to comply with the annual notice requirement would result in a deemed withdrawal of the exemption or exclusion and could result in an enforcement action.

FORMS CPO-PQR AND CTA-PR[2]

The Commission has proposed new Section 4.27, pursuant to which all CPOs and CTAs registered or required to register with the Commission would file quarterly reports[3] with the NFA on Forms CPO-PQR[4] and CTA-PR,[5] respectively. The quarterly reports would be filed within 15 days of each quarter end (*i.e.*, 15 days after March 31, June 30, September 30, or December 31). The type and extent of information that a CPO or CTA would be required to disclose would depend on both the size of each reporting CPO and CTA (as measured by the amount of assets under management ("AUM")) and the size of the advised pools. In order to eliminate duplicative filings, proposed Section 4.27(d) would allow CPOs and CTAs that are also registered as investment advisors with the SEC to satisfy certain of the Commission's reporting requirements by completing Form PF, which is being jointly promulgated with the SEC. The Commission anticipates that the proposed regulations requiring the filing of Forms CPO-PQR and CTA-PR would become effective six months after the adoption of the proposed forms.

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[2] *The full text of proposed Forms CPO-PQR and CTA_PR can be found at http://www.cftc.gov/PressRoom/Events/opaevent_doddfrank012611.html.*

[3] *CPOs with AUM equal to or greater than $150 million would also be required to file Schedule B of Form CPO-PQR annually, within 90 days of the end of the calendar year.*

[4] *Form CPO-PQR is proposed to appear in the Commission's regulations as Appendix A to part 4.*

[5] *Form CTA-PR is proposed to appear in the Commission's regulations as Appendix C to part 4.*

I. Form CPO-PQR

Proposed Form CPO-PQR has three schedules; however, only certain large CPOs would be required to complete the sections of Form CPO-PQR that require more detailed information.

A CPO that is registered or required to be registered would be required to complete Schedule A, which requests basic identifying information about the filer and the pools that it manages. This information is substantially similar to that currently required under the NFA's PQR data collection instrument. Information required by Schedule A includes:

- the name, NFA identification number and AUM of the CPO;
- the names and NFA identification numbers for each of the pools operated during the reporting period by the CPO, position information for positions comprising five percent or more of each pool's net asset value, and each pool's key relationships with brokers, other advisors and administrators, etc.;
- the name of each pool's carrying brokers, administrators, trading managers, custodians, auditors and marketers;
- quarterly and monthly performance information about each pool; and
- data regarding each pool's subscriptions and redemptions, and any restrictions thereon.

The Commission has proposed that all CPOs that are registered or required to be registered and that have AUM equal to or exceeding $150 million be required to file Schedule B of Form CPO-PQR. Information required by Schedule B includes:

- each pool's investment strategy;
- borrowings by geographic area and identities of significant creditors;
- counterparty credit exposure; and
- entities through which each pool trades and clears its positions.

Finally, the Commission has proposed that all CPOs that are registered or required to be registered and that have AUM equal to or exceeding $1 billion be required to file Schedule C of proposed Form CPO-PQR. Information required by Schedule C includes:

- certain aggregate information about the commodity pools advised by large CPOs, such as the market value of assets invested, on both a long and short basis, in different types of securities and derivatives, and turnover in these categories of financial instruments, including asset-backed securities;

- certain information about any commodity pool advised by the reporting operator with a net asset value of at least $500 million as of the end of any business day during the reporting period (each, a "reportable pool") (including a geographic breakdown of the reportable pool's assets, liquidity, concentration of positions, material investment positions, collateral practices with significant counterparties and clearing relationships);

- data regarding reportable pool risk metrics, financial information (*i.e.*, information regularly calculated by the reportable pool) and investor information;

- information regarding the impact on the reportable pool's portfolio of certain identified market factors, if applicable, broken down by the long and short components of the reportable pool's portfolio and information about whether the CPO regularly performed stress tests in which that market factor was considered as part of its risk management process;

- certain financing information for the reportable pool, including a monthly breakdown of secured, unsecured and synthetic borrowing, as well as information about the collateral supporting the secured and synthetic borrowing, the types of creditors and the term of the pool's committed financing; and

- information on the reportable pool's investor composition and liquidity (*i.e.*, use of side pockets, gates and investor liquidity).

II. Form CTA-PR
Proposed Form CTA-PR has two schedules; however, only certain large CTAs would be required to complete Schedule B, which requires more detailed information.

A CTA that is registered or required to be registered would be required to complete Schedule A, which requests basic identifying information about the filer and the pool assets directed by that CTA. This information includes:

- the name and NFA identification number of the CTA;

- the number of offered trading programs and whether any pool assets are directed under those trading programs;

- the total assets directed by the CTA; and

- the total pool assets directed by the CTA.

The Commission has proposed that all CTAs that are registered or required to be registered and that direct pool assets equal to or exceeding $150 million be required to file Schedule B of Form CTA-PR. Information required by Schedule B includes:

- detailed position, performance and trading strategy information for each trading program;
- identifying information regarding each of the pools advised under each program and the percentage of each pool's assets that are directed by the CTA; and
- whether the CTA uses an administrator.

NEW RISK DISCLOSURE STATEMENT FOR CPOS AND CTAS UNDER SECTIONS 4.24 AND 4.34

The Commission has proposed to amend the mandatory risk disclosure statements under Sections 4.24(b) and 4.34(b), for CPOs and CTAs to describe certain risks specific to swaps transactions. The new disclosure would highlight certain potential risks related to swaps, including that swaps may have limited liquidity and accordingly can be hard to value, which may result in limited liquidity for pool participants.

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Please call us if you have any questions.

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