CLIENT UPDATE

CFTC GRANTS NO-ACTION RELIEF TO FAMILY OFFICES AND FUNDS OF FUNDS

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In two letters dated November 29, 2012, the Division of Swap Dealer and Intermediary Oversight ("Division") of the Commodity Futures Trading Commission ("CFTC") offered no-action relief to family offices (the "Family Office No-Action Letter")[1] and funds of funds (the "FOF No-Action Letter").[2]

The relief is offered in light of the CFTC's February 2012 rescission of section 4.13(a)(4) of the Regulations under the Commodity Exchange Act,[3] which generally provided an exemption from commodity pool operator ("CPO") registration if interests in a commodity pool were exempt from registration under the Securities Act of 1933 (the "Securities Act") and the operator reasonably believed that participants in the pool were qualified eligible persons ("QEPs").[4]

The Family Office No-Action Letter provides relief from registration as a CPO to certain family offices that (i) submit a claim for the relief

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1 Available at http://www.cftc.gov/PressRoom/PressReleases/pr6434-12

2 Available at http://www.cftc.gov/PressRoom/PressReleases/pr6435-12

3 Unless otherwise indicated, all section references are to the Regulations.

The repeal of section 4.13(a)(4), the section 4.13 de minimis test, Prior Appendix A (defined below), and other amendments to Part 4 are further discussed in our Client Update, *Amendments to CFTC Part 4 Regulations Regarding Commodity Pool Operators and Commodity Trading Advisors*, available at http://www.debevoise.com/newseventspubs/publications/detail.aspx?id=e42014f7-c21f-4106-8932-383132e8b16a

4 A criteria based on assets owned by an individual or entity, QEP is defined under section 4.7(a)(2), and includes, but is not limited to, a "qualified purchaser" as defined in section 2(a)(51)(A) of the Investment Company Act of 1940 and a non-U.S. person.

and (ii) remain in compliance with rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940 (the "Advisers Act").

The FOF No-Action Letter provides temporary relief from registration as a CPO to certain funds of funds ("FOFs") until the later of June 30, 2013 or six months from the date that the Division issues revised guidance on the application of the calculation of the de minimis thresholds in the context of sections 4.5 and 4.13(a)(3), subject to certain requirements.

FAMILY OFFICE NO-ACTION LETTER

Private family offices sometimes are established by wealthy families to provide financial, legal, management, and other services to family members, trusts for the benefit of family members, and entities owned and controlled by family members. The term "family office" is defined in rule 202(a)(11)(G)-1 under the Advisers Act as a company with three key characteristics: (i) it has no clients other than family clients (that is, current and former members of a single family and certain other categories of clients); (ii) it is wholly owned by the family clients and is exclusively controlled (directly or indirectly) by family members and/or family entities; and (iii) it does not hold itself out to the public as an investment adviser.[5]

Typically, family offices previously relied on an exemption from registration as a CPO pursuant to section 4.13(a)(4). Following the rescission of section 4.13(a)(4), family offices seeking an exemption from CPO registration were required to rely on section 4.13(a)(3), to the extent applicable, or to write in on an office-by-office basis to request interpretive relief from the CFTC's registration and compliance obligations.

The Family Office No-Action Letter acknowledges that family offices are not operations of the type and nature that warrant regulatory oversight by the CFTC, and that family offices have a reduced need for the customer protections available under Part 4 as they are comprised of participants with close relationships whose relevant disputes may be resolved within the family or through state laws designed to address family disputes. The Division notes that the Securities and Exchange Commission ("SEC") excluded family offices from registration as an investment adviser under similar reasoning, and that placing both agencies on equal footing regarding family office investor protections will facilitate compliance with both regulatory regimes. In keeping with the SEC's rule, which

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[5] The Securities and Exchange Commission's release defining "family office" is discussed in detail in our Client Update, *SEC Adopts Rule Defining "Family Office" under the Investment Advisers Act*, available at http://www.debevoise.com/newseventspubs/publications/detail.aspx?id=e3af8146-84ea-428e-a606-f8cedcd6e62c

does not apply to family offices serving multiple families, the family office exclusion from Part 4 does not apply to multi-family offices.

The Division will not recommend enforcement action for failure to register as a CPO against a family office as defined under the Advisers Act, provided that it (i) submits a claim for the relief and (ii) remains in compliance with rule 202(a)(11)(G)-1 under the Advisers Act, regardless of whether the family office seeks to be excluded from registration as an investment adviser.

Although the relief is not self-executing, complete claims by eligible CPOs to perfect the relief will be effective upon filing. The claim of no-action must:

- State the name, main business address, and main business telephone number of the CPO claiming the relief;
- State the capacity (i.e., CPO) and, where applicable, the name of the pool(s), for which the claim is being filed;
- Be electronically signed by the CPO; and
- Be filed with the Division via email to dsionoaction@cftc.gov with the subject line "Family Office" before December 31, 2012 (for family offices in operation as of December 1, 2012), or, for a family office that begins to operate after December 1, 2012, within 30 days after it commences operation as a family office.

In addition, before March 31, 2013 (or, for a family office that begins to operate after March 31, 2013, within 30 days after it commences operation as a family office), such family office must confirm that it is a family office within the meaning and intent of rule 202(a)(11)(G)-1 under the Advisers Act, and that it will notify the Division if it is no longer a family office within the meaning and intent of such regulation.

FUNDS OF FUNDS NO-ACTION LETTER

The February 2012 rescission of section 4.13(a)(4), which FOFs typically relied on, was accompanied by the rescission of Appendix A of Part 4, "Guidance on the Application of Rule 4.13(a)(3) in the Fund of Funds Context" ("Prior Appendix A"). Prior Appendix A provided guidance to operators of FOFs on how to apply the section 4.13(a)(3) "de minimis test" to pass-through exposure of a FOF to the commodity interest positions of its investee funds. The Division announced in August 2012 that CPOs of FOFs may continue to rely on Prior Appendix A until such time as the CFTC adopts revised guidance (the

"Forthcoming Guidance"),[6] but it did not extend the registration deadline. As the Forthcoming Guidance may alter the analysis FOFs use when determining whether to register as a CPO or file an exemption under the de minimis test, absent relief, FOFs that previously operated under section 4.13(a)(4) would potentially be required to register as of December 31, 2012 under a shifting compliance regime.

The FOF No-Action Letter provides that (i) the Forthcoming Guidance will apply to application of the de minimis test under 4.13(a)(3) and will be broadened to include the identical threshold calculation test under section 4.5, and (ii) the Division will provide temporary relief until the later of June 30, 2013 or six months from the date the Division issues the Forthcoming Guidance to certain CPOs of FOFs that may otherwise be required to register as a result of indirect exposure to commodity interests.

The Division will not recommend enforcement action for failure to register as a CPO against any operator of a FOF, provided that it (i) submits a claim for the relief, and (ii) remains in compliance with the following criteria:

- The CPO currently structures its operations in whole or in part as a CPO of one or more FOFs;
- The amount of commodity interest positions to which the FOF is *directly* exposed does not exceed the levels specified in section 4.5 or the section 4.13(a)(3) de minimis test;
- The CPO does not know and could not have reasonably known that such FOF's indirect exposure to commodity interests derived from contributions to investee funds exceeds the levels specified in section 4.5 or the section 4.13(a)(3) de minimis test, either calculated directly or through the use of Prior Appendix A; and
- The commodity pool for which the CPO seeks relief is either (i) an investment company registered as such under the Investment Company Act of 1940, or (ii) compliant with the provisions of section 4.13(a)(3)(i), (iii), and (iv).[7]

Although the relief is not self-executing, materially complete claims by eligible CPOs to perfect the relief will be effective upon filing. The claim of no-action must:

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[6] Additional detail regarding the frequently asked question release is available in our Client Update, *CFTC Responds to Frequently Asked Questions – CPO/CTA: Amendments to Compliance Obligations*, available at http://www.debevoise.com/newseventspubs/publications/detail.aspx?id=5c001ff8-376a-47e1-882a-f38a9f06b915

[7] Such subsections of section 4.13(a)(3) generally provide that: (i) interests in the pool must be exempt from registration under the Securities Act; (ii) the pool may not be marketed to the public in the United States; (iii) the pool may not be marketed as or in a vehicle for trading in the commodity futures or commodity options markets; and (iv) each investor in the pool must be an "accredited investor" (as defined in Rule 501(a) of the rules promulgated under the Securities Act) (or a trust that is not an accredited investor but that was formed by an accredited investor for the benefit of a family member), a "knowledgeable employee" (as defined in rule 3c5 under the Investment Company Act) or a "QEP."

- State the name, main business address, and main business telephone number of the CPO claiming relief;
- State the capacity (i.e., CPO) and the name of the pool(s) for which the claim is being filed;
- Be signed by the CPO (which may be effected by attaching a signed pdf statement from the CPO); and
- Be filed with the Division via email to dsionoaction@cftc.gov with the subject line "Fund-of-Funds" before December 31, 2012.

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Please do not hesitate to contact us with any questions.

December 5, 2012