

# CLIENT UPDATE

## RECENT COMPLIANCE GUIDANCE FROM THE NATIONAL FUTURES ASSOCIATION

### NEW YORK

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The National Futures Association (the “NFA”) has recently released a number of notices to members, summarized as follows and addressed in detail under the respective section headings below.

- Any person claiming an exemption or exclusion from commodity pool operator (“CPO”) registration under Commodity Futures Trading Commission (the “CFTC”) Regulation 4.5, 4.13(a)(1), 4.13(a)(2), 4.13(a)(3), or 4.13(a)(5) or commodity trading advisor (“CTA”) registration under CFTC Regulation 4.14(a)(8) must annually affirm the applicable exemption or exclusion within 60 days of each calendar year end, via the NFA’s online exemption system. The first annual affirmation is due by March 1, 2013, and applies to CPOs and CTAs that filed an exemption or exclusion before January 2013. However, based on our conversations with NFA staff, an exemption or exclusion claimed on or after December 3, 2012 will be treated by the NFA as affirmed for 2013.
- Until the NFA issues further guidance, NFA members (“Members”) that are registered CPOs and advise a registered investment company (“RIC”) under the Investment Company Act of 1940 will be considered in compliance with NFA Bylaw 1101 (“Bylaw 1101”) if such registered CPO ensures that any futures commission merchant (an “FCM”) through which the RIC transacts any commodity interest transactions and any sub-adviser that provides investment management services to the RIC is properly registered in the appropriate capacity and a Member, or in the case of the sub-adviser, exempt from CTA registration.

- NFA Members that take reasonable steps to determine the registration and Membership status of previously exempt persons will not be in violation of NFA Bylaw 1101 if, between January 1 and March 31, 2013, they transact customer business with a previously exempt person that fails to (i) become registered and a Member of NFA, (ii) file a notice affirming its exemption from CPO registration or (iii) provide a written representation as to why the person is not required to register or file the notice affirming the exemption.
- A Member carrying an account, accepting an order or handling a transaction in commodity interests from certain pending introducing broker (“IB”) Members will be considered in compliance with Bylaw 1101 even if the IB is not an approved IB Member, provided that the Member by January 31, 2013 obtains a written representation from the pending IB Member that it meets the conditions set forth in CFTC No-Action Letter No. 12-15 (“Letter No. 12-15”).
- CTA Members must file a Form PR annual report with the NFA within 45 days of the calendar year end, providing general information about such CTA, its trading programs, the pool assets directed by it, and the identity of the CPOs that operate those pools. The first annual Form PR report will be due by February 14, 2013 for the year ended December 31, 2012 and must be filed electronically using the NFA’s EasyFile System. CTA Members should note that the NFA has proposed changes to its Compliance Rule 2-46 to require a similar CTA PR filing to be made within 45 days of each calendar quarter end, and expects that the first filing under this amendment will be due for the quarter ending March 31, 2013.
- Every CPO Member that operates a commodity pool that is also a RIC must notify the NFA of this fact by February 15, 2013 through the CPO’s annual questionnaire by answering “yes” to the question “Is this pool a Registered Investment Company?,” which appears at the end of each pool’s annual questionnaire.

## **ANNUAL AFFIRMATION REQUIREMENT FOR ENTITIES OPERATING UNDER AN EXEMPTION OR EXCLUSION FROM CPO OR CTA REGISTRATION**

On February 9, 2012, the CFTC adopted final rules (the “Final Rules”) amending part 4 of the Regulations under the Commodity Exchange Act regarding CPOs and CTAs.<sup>1</sup>

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<sup>1</sup> See 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>

Among other amendments, the Final Rules require that any person claiming an exemption or exclusion from CPO registration under CFTC Regulation 4.5, 4.13(a)(1), 4.13(a)(2), 4.13(a)(3), or 4.13(a)(5) or CTA registration under CFTC Regulation 4.14(a)(8) (together, the “Affirmation Regulations”) must annually affirm the applicable exemption or exclusion within 60 days of each calendar year end. Such affirmation must be completed via the online exemption system provided by the NFA.<sup>2</sup>

The first annual affirmation is due by March 1, 2013, and applies to CPOs and CTAs that filed an exemption or exclusion before January 2013. However, based on our conversations with NFA staff, this year any exemption or exclusion filed on or after December 3, 2012 will be treated by the NFA as affirmed.

However, based on our conversations with NFA staff, an exemption or exclusion claimed on or after December 3, 2012 will be automatically treated by the NFA as affirmed for 2013, and confirmed as such on the NFA’s online filing information system, BASIC (“BASIC”).

### *Failure to Affirm*

Any failure to file such annual affirmation will be deemed a request to withdraw the relevant exemption or exclusion, and will result in the automatic withdrawal of the exemption or exclusion once the 60-day period has elapsed.

For registered CPOs or CTAs, withdrawal of the exemption/exclusion will result in the relevant CPO or CTA being subject to requirements under Part 4 of the CFTC Regulations for that pool regardless of whether such CPO or CTA otherwise remains eligible for the exemption or exclusion. Non-registrants whose exemption or exclusion is withdrawn may be required to register as a CPO and/or CTA and, accordingly, an NFA Member in order to continue to operate the pool.

### *Annual Reminder*

The NFA will provide an annual email reminder of the affirmation process. The email reminder will be sent to the email contact on file in NFA’s Exemption System. CPOs and CTAs are therefore urged to ensure a current email address is on file in the system, particularly if contact information changes during the year.

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<sup>2</sup> Available at <http://www.nfa.futures.org/nfa-electronic-filings/exemptions.html> See also, NFA Notice to Members I-12-30, available at <http://www.nfa.futures.org/NFA-regulation/regulationNotice.asp?ArticleID=4158>

### *Inactive Pools*

If the NFA's records reflect an exemption for a pool that is no longer active, (i) registered CPOs can update their records by withdrawing the exemption via the NFA's electronic exemption system or (ii) non-registered CPOs can update their records by notifying the NFA via email at [exemptions@nfa.futures.org](mailto:exemptions@nfa.futures.org) with specific information about the pool, including the full name of the pool and the relevant entity.

### *Confirmation*

BASIC will indicate whether a CPO/CTA exemption/exclusion has been successfully affirmed, along with the date of affirmation, or a withdrawal date will be reflected for any exemption that was not affirmed for a given CPO/CTA. NFA Members may access a spreadsheet that includes a list of all entities with exemptions that must be affirmed on an annual basis (the "Affirmation Spreadsheet").<sup>3</sup>

## **OBLIGATIONS UNDER NFA BYLAW 1101 AND COMPLIANCE RULE 2-36(D) FOR REGISTERED CPOS ADVISING POOLS THAT ARE REGISTERED INVESTMENT COMPANIES**

Bylaw 1101 prohibits Members from carrying an account, accepting an order, or handling a transaction in commodity interests for or on behalf of any non-Member or suspended Member that is required to be registered with the CFTC as a FCM, IB, leverage transaction merchant ("LTM"), CPO, or CTA, and that is acting in respect to the account, order or transaction for a customer, a commodity pool or participant therein, a client of a CTA, or any other person.<sup>4</sup>

A number of registered investment advisers that advise RICs were required as of December 31, 2012 to register as CPOs if the RIC no longer qualified for the exclusion from CPO registration under CFTC Regulation 4.5, thereby becoming subject to the Bylaw 1101 requirement that registered CPO Members must determine if any participants in their pools are required to be registered. However, the NFA acknowledges<sup>5</sup> that certain

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<sup>3</sup> Such spreadsheet is updated nightly and includes all entities with an exemption that requires affirmation, as well as the affirmation date, if applicable; if the spreadsheet does not reflect an affirmation date, the exemption has not been affirmed. Available at <http://www.nfa.futures.org/nfa-electronic-filings/annual-questionnaire.html>

<sup>4</sup> Bylaw 1101 also prohibits a Member from accepting orders in commodity futures contracts to cover leverage transactions for or on behalf of any non-Member or suspended member that is required to be registered with the CFTC as an LTM, subject to largely identical exemptions.

<sup>5</sup> See NFA Notice to Members Notice I-12-34, available at <http://www.nfa.futures.org/NFA-regulation/regulationNotice.asp?ArticleID=4170>

registered CPOs to RICs may not be able to comply fully with Bylaw 1101 because, due to the distribution channels used with respect to these RICs, such CPO does not currently have access to information relating to such RIC's underlying participants.

Accordingly, until the NFA issues further guidance, Members that are registered CPOs and advise a RIC will be considered in compliance with Bylaw 1101 if such registered CPO ensures that any FCM through which the RIC transacts any commodity interest transactions and any sub-adviser that provides investment management services to the RIC is properly registered in the appropriate capacity and a Member, or in the case of the sub-adviser, exempt from CTA registration.<sup>6</sup> The registered CPO Member to a RIC will not currently be required to conduct Bylaw 1101 due diligence on the RIC's underlying participants.

### **MEMBER OBLIGATIONS UNDER NFA BYLAW 1101 AND COMPLIANCE RULE 2-36(D) WITH RESPECT TO CPOS/CTAS EXEMPT FROM REGISTRATION BEFORE DECEMBER 31, 2012**

Although by its terms Bylaw 1101 imposes strict liability on any Member conducting customer business with a non-Member that is required to be registered, NFA enforcement has focused on evidence indicating that the Member knew or should have known of the violation.

Following the adoption of the Final Rules, the NFA intends to follow the same evidence-based approach and will provide limited-time relief from Bylaw 1101's prohibition for Members transacting customer business with unregistered persons that were exempt from CPO or CTA registration prior to December 31, 2012, provided the Member is taking reasonable steps to ensure it is in compliance. Further, the NFA acknowledges that, until the exemption affirmation process is completed, it may be difficult for Members to determine whether a previously exempt CPO/CTA continues to be eligible for a current exemption.

Therefore, Members that take reasonable steps to determine the registration and Membership status of previously exempt persons will not be in violation of NFA Bylaw 1101 if, between January 1 and March 31, 2013, they transact customer business with a previously exempt person that fails to (i) become registered and a Member of NFA, (ii) file a notice affirming its exemption from CPO registration, or (iii) provide a written

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<sup>6</sup> This relief described in this section also applies to a similar prohibition under NFA Rule 2-36(d), which prohibits NFA Members from engaging in forex transactions with non-Members that are required to be registered as a FCM, Retail Foreign Exchange Dealer, IB, CPO or CTA in connection with its forex activities ("NFA Rule 2-36(d)").

representation as to why the person is not required to register or file the notice affirming the exemption.<sup>7</sup>

### *With Regard to the Affirmation Regulations*

For those persons who previously claimed an exemption from CPO registration under the Affirmation Regulations who have not (i) filed a notice reaffirming the exemption, (ii) filed a notice of exemption for another available exemption or (iii) properly registered and become an NFA Member by December 31, 2012, the NFA expects any Member transacting customer business with that person to promptly determine whether the person intends to file a notice affirming the exemption.

If the Member learns that the person does not intend to file a notice affirming the exemption or the person does not file a notice affirming the exemption by March 1, 2013, then the Member must (i) promptly obtain a written representation as to why the person is not required to register or file a notice exemption, and (ii) evaluate whether the representation appears adequate based upon the information that the Member knows about the person (the “1101 Representation and Evaluation Requirement”). If the Member ultimately determines that the person’s written representation is inadequate and the person is required to be registered, then the Member must put a plan in place (e.g., liquidation-only trades) to cease transacting customer business with the person or risk violating NFA Bylaw 1101 (the “1101 Plan Requirement”).

### *With Regard to Regulation 4.13(a)(4)*

The Final Rules rescinded the exemption from CPO registration available under CFTC Regulation 4.13(a)(4) for certain qualifying pools as of December 31, 2012. In most instances, any person who previously operated a Regulation 4.13(a)(4) exempt pool was required to either register as a CPO or qualify and file for another available exemption.

The limited-time relief is also available to Members that conduct customer business with persons who were previously exempt under Regulation 4.13(a)(4) to ensure that the Member has sufficient time to determine whether the person is required to be registered. For those persons that previously claimed an exemption under 4.13(a)(4) who have not filed for another available exemption or properly registered and become an NFA Member by December 31, 2012, the NFA expects any Member transacting customer business with such person to follow (i) the 1101 Representation and Evaluation Requirement described

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<sup>7</sup> See NFA Notice to Members I-12-35, available at <http://www.nfa.futures.org/NFA-regulation/regulationNotice.asp?ArticleID=4171>

above, and (ii), if the Member ultimately determines that the person is required to be registered, the 1101 Plan Requirement.

### *Compliance Guidance*

The NFA expects Members to take reasonable steps to identify those persons who currently claim an exemption from CPO/CTA registration with whom the Member transacts customer business, including reviewing BASIC and the Affirmation Spreadsheet.<sup>8</sup>

Any Member that acts in accordance with the guidance provided by the NFA will not be charged with violating NFA Bylaw 1101. Members should be aware, however, that they are not relieved from their regulatory obligations pursuant to the Commodity Exchange Act (“CEA”) and the CFTC’s Regulations.<sup>9</sup>

### **MEMBER OBLIGATIONS UNDER NFA BYLAW 1101 WITH RESPECT TO CERTAIN IBS AFFORDED TEMPORARY REGISTRATION NO-ACTION RELIEF**

On October 11, 2012, the CFTC issued Letter No. 12-15,<sup>10</sup> which, in part and subject to certain conditions, granted temporary no-action relief from the registration requirements of the CEA and the regulations of the CFTC issued thereunder to persons coming within the definition of an IB where the requirement to register arises solely from the person being involved with certain Intercontinental Exchange, Inc. (“ICE”) and New York Mercantile Exchange (“NYMEX”) contracts.<sup>11</sup>

<sup>8</sup> Members should be aware that prior to January 1, 2003, the NFA was not the sole custodian of Notices of Exemption and, therefore, any notice filed before that date will not be noted in BASIC and may not appear on the NFA’s spreadsheet. Any Member transacting customer business with an unregistered person who does not appear on the NFA’s spreadsheet, and who the Member has reason to believe is required to be registered, should inquire with that person whether the exemption was filed prior to 2003 and, if so, advise that person to contact the NFA and re-file the exemption through the NFA’s Electronic Exemption System. The Member will be able to confirm whether the exemption was re-filed by subsequently reviewing BASIC or the spreadsheet.

<sup>9</sup> The relief described in this section also applies to NFA Rule 2-36(d).

<sup>10</sup> See our Client Update, CFTC Grants Registration Relief for Certain Persons and Other Relief for Certain Associated Persons, available at <http://www.debevoise.com/newsevents/pubs/publications/detail.aspx?id=2ba14d5d-3d28-42ea-920c-0c9e742f921d>

<sup>11</sup> Such contracts are: (i) in the case of ICE, the transition of its cleared ICE OTC energy swap products to energy futures and options contracts traded on ICE Futures US and ICE Futures Europe; and (ii) in the case of NYMEX, the transition of certain energy transactions submitted for clearing through CME ClearPort via Exchanges of Futures for Risk transactions to energy transactions executed off the centralized market but subject to NYMEX’s rules and submitted for clearing as futures and options transactions.

Letter No. 12-15 advised that the CFTC would not commence an enforcement action against a person for failing to register as an IB where the person’s requirement to be registered arises solely from the person’s swaps activities. However, the relief described in this section is not necessary for these swap-only IBs since NFA Bylaw 1101 does not currently apply to swaps transactions.

Letter No. 12-15 provides assurance that as long as a person filed an application for registration on or before December 31, 2012, and complies with certain conditions and registration application requirements, then engaging in activities requiring registration before the person has been registered will not, in and of itself, result in enforcement action against the person. Moreover, Letter No. 12-15 recognized that the no-action relief will enable the NFA to perform the registration function in an orderly manner.

Letter No. 12-15 contemplates that certain persons registering as IBs where the requirement to be registered arises from the person's involvement with ICE/NYMEX contracts may continue to engage in these activities after December 31, 2012 even if they are not registered, provided they meet the conditions set forth in such letter. BASIC will display these IBs' registration and NFA membership statuses as pending until the person is registered as an IB and approved as an NFA Member.

As a result, a Member carrying an account, accepting an order or handling a transaction in commodity interests from these pending IB Members will be considered in compliance with Bylaw 1101 even if the IB is not an approved NFA IB Member; provided that the Member by January 31, 2013 obtains a written representation from the pending IB Member that it meets the conditions set forth in Letter No. 12-15. A Member's relief from Bylaw 1101 with respect to a pending IB Member meeting the no-action letter's conditions will terminate on the date that the IB becomes an approved NFA Member or five days after service by NFA upon the pending IB Member pursuant to NFA Registration Rule 504 that it may be disqualified from registration under CEA Section 8a(2) or 8a(3).

Any Member that acts in accordance with the guidance provided by the NFA will not be charged with violating NFA Bylaw 1101.<sup>12</sup> Members should be aware, however, that they are not relieved from their regulatory obligations pursuant to the CEA and the CFTC's Regulations.

#### **CFTC REGULATION 4.27: CTA MEMBER REPORTING REQUIREMENTS**

The NFA released Notice to Members I-13-02<sup>13</sup> reminding CTA Members to file a Form PR<sup>14</sup> annual report with the NFA within 45 days of the calendar year end, pursuant to CFTC Regulation 4.27. Form PR requires that each CTA Member report on an annual basis

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<sup>12</sup> See NFA Notice to Members I-12-37 available at <http://www.nfa.futures.org/NFA-regulation/regulationNotice.asp?ArticleID=4175>

<sup>13</sup> Available at <http://www.nfa.futures.org/NFA-regulation/regulationNotice.asp?ArticleID=4179>

<sup>14</sup> Form PR template available at <http://www.nfa.futures.org/NFA-electronic-filings/CTA-PR.pdf>

general information about such CTA, its trading programs, the pool assets directed by it, and the identity of the CPOs that operate those pools.

The first annual Form PR report will be due by February 14, 2013 for the year ended December 31, 2012 and must be filed electronically using the NFA's EasyFile System.<sup>15</sup>

CTA Members should also note that the NFA has proposed changes to its Compliance Rule 2-46 to require a similar CTA PR filing to be made within 45 days of each calendar quarter end, and expects that the first filing under this amendment will be due for the quarter ending March 31, 2013.

### **NFA REQUEST FOR INFORMATION: MANDATORY RESPONSE FROM CPO MEMBERS OPERATING A POOL THAT IS A REGISTERED INVESTMENT COMPANY**

Once a year, NFA Members must complete an Annual Questionnaire.<sup>16</sup> In light of recent changes to the CFTC Part 4 Regulations, the NFA is requiring every CPO Member that operates a commodity pool that is also a RIC under the Investment Company Act of 1940 to notify the NFA of this fact through the CPO's annual questionnaire by answering "yes" to the question "Is this pool a Registered Investment Company?," which appears at the end of each pool's annual questionnaire. Any CPO operating a pool that is also a RIC should provide the NFA with this information by February 15, 2013.

According to NFA Notice to Members I-13-04,<sup>17</sup> the NFA is requesting this information in order to identify pools that do not have to comply with certain requirements under Part 4 of the CFTC regulations and certain NFA Rules until the CFTC adopts final rules governing the compliance framework for RICs subject to CFTC jurisdiction.

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Please do not hesitate to call us if you have any questions.

January 30, 2013

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<sup>15</sup> Once the CTA's security manager configures certain security settings, the EasyFile System can be accessed at <http://www.nfa.futures.org/NFA-electronic-filings/easyFile-CTA-filers.html>

<sup>16</sup> If the CPO's annual questionnaire is due, the CPO must complete the entire questionnaire, including the Registered Investment Company question, for each pool. The CPO Questionnaire is available at: <http://www.nfa.futures.org/NFA-electronic-filings/annual-questionnaire.html>

<sup>17</sup> Available at <http://www.nfa.futures.org/NFA-regulation/regulationNotice.asp?ArticleID=4181>