CLIENT UPDATE

PROPOSED AMENDMENTS TO NFA RULE 2-45 AND ITS RELATED INTERPRETIVE NOTICE FOR MEMBER CPOs

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On March 4, 2013, the National Futures Association ("NFA") released a letter (the "Proposed Amendment")[1] describing proposed amendments and guidance regarding NFA Compliance Rule 2-45 and its related Interpretive Notice ("Rule 2-45"). The Proposed Amendment will become effective on or about March 14, 2013 unless the Commodity Futures Trading Commission ("CFTC") notifies the NFA that it wishes to engage in further review.

The NFA adopted Rule 2-45 in September 2009, prohibiting commodity pool operators ("CPOs") that are members of the NFA ("Member CPOs") from permitting, by any means, their commodity pools to make a direct or indirect loan or advance of pool assets to such CPO or any other affiliated person or entity.[2]

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1 "Prohibition of Loans by Commodity Pools to CPOs and Affiliated Entities – Proposed Amendments to NFA Compliance Rule 2-45 and its Related Interpretive Notice" available at http://www.nfa.futures.org/news/.%5CPDF%5CCFTC%5CCR2-45_InterpNotc_ProhibitLoansByCommodityPoolsToCPOs_022113.pdf

2 The NFA's Board determined that this prohibition was necessary due to a series of disciplinary actions the NFA had taken in which CPOs and CPO principals directly or indirectly loaned or advanced pool assets to themselves or an affiliated person or entity. Via these arrangements, the CPOs' principals used the loan proceeds to purchase luxury items, while others went to related entities that did not have sufficient assets to repay the loans. In each case, the transaction resulted in significant losses to participants' funds.

On February 9, 2012, the CFTC adopted final rules (the "Final Rules") amending part 4 of the Regulations under the Commodity Exchange Act ("CEA") regarding CPOs.[3] CPOs are required to register with the CFTC and become a Member CPO unless an exemption is available under the CEA or the CFTC Regulations. Among other amendments, the Final Rules repealed section 4.13(a)(4), an exemption from CPO registration commonly used by operators of private funds, making it necessary for many private funds that were previously exempt to register with the CFTC and become Member CPOs prior to December 31, 2012.

COMPLIANCE FOR NEW MEMBER CPOS

The NFA acknowledges that Member CPOs that would be exempt from registration but for the Final Rules may have, as part of their normal course of business, previously caused their pools to make certain types of loan or advance arrangements that would violate Rule 2-45. The Proposed Amendment requires such CPOs to notify the NFA of these existing arrangements within 30 days of either (i) the effective date of any amendments to Compliance Rule 2-45 or its Interpretive Notice or (ii) becoming a Member CPO, whichever occurs latest.

PROPOSED AMENDMENTS TO RULE 2-45

The NFA's CPO/CTA Advisory Committee finds that certain transactions with characteristics similar to a loan should not be considered a violation of Rule 2-45 if certain conditions are met. Such transactions include those associated with short securities sales; cash financings; guarantee obligations; repurchase or reverse-repurchase agreements; tax-related distributions; and transactions permitted by the Investment Company Act of 1940 (the "ICA") and its exemptive rules, and Exemptive Orders issued by the Securities and Exchange Commission ("SEC") and No-Action Letters Issued by SEC Staff under Sections 17 and 57 of the ICA.

According to the Proposed Amendment, the transactions described under each of the headings below are not considered a prohibited loan or advance under Rule 2-45 and are therefore excluded from the rule's prohibition.

CERTAIN SECURITIES BORROWINGS/SECURITIES LOANS

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[3] 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

A pool that is selling a security short may locate and borrow the security from a pool operated by the same CPO (where the CPO of both pools is fully aware of the securities that are available in the lending pool's portfolio and the security can be easily located); *provided that,* no later than the close of business on the day of the securities loan, the pool lending the security has received from the pool borrowing the security collateral with a market value at least equal to the market value of the borrowed security.

SECURITIES LOANS FOR CASH FINANCING

A pool may raise cash by "loaning" its securities positions to an affiliate as part of a prime brokerage service, and receiving cash based on the market value of these securities; *provided that*: (i) the transaction is cleared by an affiliated prime broker that is registered with the SEC as a broker-dealer, is a member of FINRA, the Depository Trust Company and the National Securities Clearing Corporation and (ii) the transaction is documented under a Master Securities Loan Agreement.

GUARANTEE OBLIGATIONS

One or more pools may make a direct or indirect debt or equity investment in a subsidiary or other affiliated entity (for tax, legal, regulatory or other reasons) and guarantee or otherwise support (e.g., by pledging collateral) certain of the entity's obligations, and provide such guarantees or support in accordance with the pool's relative investment in the entity from time to time; *provided that* a pool is not liable for an amount that is materially above its proportionate share (based on the pool's relative investment in the entity from time to time).

REPURCHASE AGREEMENTS AND REVERSE REPURCHASE AGREEMENTS

Affiliated pools may engage in repurchase agreements/reverse repurchase agreements in which there is a sale of securities combined with a contemporaneous agreement for the seller to buy back the securities at a later date at a higher price; such transactions do not violate Rule 2-45 because the buyer's possession of the securities effectively collateralizes the buyer's exposure in respect to the seller's obligation to repurchase the securities.

TAX-RELATED DISTRIBUTIONS

Pools may make certain tax-related loans, advances or distributions (such as making loans or advances from the pool to the CPO (or a related party) to enable it to meet tax obligations, or making distributions to the CPO (or a related party) from the pool based on

the CPO's (or related party's) share of the pool's taxable income) (collectively, a "distribution"); *provided that:*

- they are made in strict accordance with the provisions of the pool's organizational documents that expressly permit the distribution;
- they relate solely to the CPO's (or related party's) taxable income arising from the pool (and not to any other income); and
- if the CPO's (or related party's) taxable income arising from operating the pool is ultimately lower than that on which the distribution was based, resulting in an excess distribution amount having been made, the CPO ensures repayment is made to the pool, as promptly as reasonably practicable and in a manner determined by the CPO, (i) of any portion of the excess distribution not already paid to an applicable tax authority and (ii) with respect to any portion of the excess already paid to a tax authority, of any refund or credit received with respect to such payment.

TRANSACTIONS PERMITTED BY THE ICA AND ITS EXEMPTIVE RULES; AND EXEMPTIVE ORDERS ISSUED BY THE SEC AND NO-ACTION LETTERS ISSUED BY SEC STAFF UNDER SECTIONS 17 AND 57 OF THE ICA

The ICA restricts certain transactions between registered investment companies ("RICs") and their affiliates under Section 17, and between business development companies ("BDCs") and their affiliates under Section 57. However, RICs and BDCs are permitted to engage in certain loans or advances of fund assets pursuant to the ICA, exemptive rules under the ICA, exemptive orders issued by the SEC and no-action letters issued by SEC staff subject to specific conditions set forth in the respective issuance, as applicable, that are designed to ensure that the inter-fund loans only occur in circumstances that are favorable to both funds and not in circumstances when an affiliate might cause a fund to engage in transactions that are detrimental to the interest of one of the funds.

Accordingly, a pool that is also a RIC or BDC may enter into transactions permitted pursuant to (i) the ICA, (ii) exemptive rules promulgated under the ICA, (iii) exemptive orders issued by the SEC or (iv) no-action letters issued by SEC staff pursuant to Sections 17 or 57 of the ICA, as applicable.

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Please do not hesitate to contact us with any questions.

March 8, 2013