

**NATIONAL FUTURES ASSOCIATION PETITIONS COMMODITY FUTURES
TRADING COMMISSION TO RESTORE RESTRICTIONS ON
MUTUAL FUNDS THAT TRADE COMMODITIES**

The National Futures Association has petitioned the Commodity Futures Trading Commission to reinstate the trading and marketing limitations previously applicable to registered investment companies that trade futures and options on futures.¹ The Petition asserts that managed futures trading vehicles offered to retail investors should be subject to CFTC and NFA disclosure rules and oversight, even if they are subject to another regulatory regime.

The Commodity Exchange Act and CFTC rules promulgated thereunder provide a comprehensive regulatory framework for collective investment vehicles that engage in futures and options on futures trading. The Act refers to such vehicles as “commodity pools.” Absent an exemption or exclusion, the sponsor of a commodity pool must register with the CFTC as a commodity pool operator (“CPO”), become a member of NFA and comply with disclosure, reporting and recordkeeping requirements. CFTC Rule 4.5 provides an exclusion from the definition of CPO for certain entities that are subject to oversight by another regulator. These otherwise regulated entities include investment companies registered with the SEC, regulated insurance companies, banks and pension plans, provided that they meet certain conditions. Rule 4.5 entities are not required to register with the CFTC or become members of NFA. For many years, Rule 4.5 limited the level of speculative futures trading and prohibited marketing the entity as a futures trading vehicle. In August 2003, the CFTC eliminated these trading and marketing limitations. Thus, qualified entities that avail themselves of the Rule 4.5 exclusion currently are permitted to use any amount of futures for speculative or hedging purposes and may market their interests as commodity pools or futures-related investments.

The Petition recommends reinstating the old Rule 4.5 language with a notable exception. The entity would need to represent that its use of futures and options on futures would be limited to (i) bona fide hedging transactions and (ii) speculative futures positions “*that may be held by a qualifying entity only,*” provided that futures margin and option premiums for such speculative positions do not exceed 5% of the liquidation value of the qualifying entity’s portfolio. The addition of the words “*that may be held by a qualifying entity only,*” which were not in the prior version of Rule 4.5, would appear to permit only the entity that files for the relief to rely on it, and not, for example, a wholly owned subsidiary of the entity, unless the subsidiary also satisfies the requirements of Rule 4.5. The Petition also proposes reinstating the marketing restrictions that were in the prior version of Rule 4.5. Specifically, if the change proposed by the Petition were made, a Rule 4.5 entity could not be marketed to the public as “a commodity pool or otherwise as . . . a vehicle for trading in (or otherwise seeking investment exposure to) the commodity futures or commodity options markets.”

¹ The NFA’s June 29, 2010 petition (the “Petition”) can be found at <http://www.nfa.futures.org/news/newsPetition.asp?ArticleID=2491>

Should the CFTC decide to proceed with a rulemaking pursuant to the Petition, it would publish a notice of proposed rulemaking and request public comment on the proposal.

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If you have any questions regarding this memorandum, please contact Rita M. Molesworth (212-728-8727, rmolesworth@willkie.com) or the Willkie attorney with whom you regularly work.

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July 1, 2010

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