

**SEC AND CFTC PROPOSE PRIVATE FUND REPORTING RULES****AGENCIES INTRODUCE NEW FORMS PF, CPO-PQR AND CTA-PR****CFTC PROPOSES TO LIMIT REGISTRATION EXEMPTIONS**

The Securities and Exchange Commission and the Commodity Futures Trading Commission have proposed new risk reporting rules that require advisers to various private funds to report their position and other data to the agencies.<sup>1</sup> Information collected under the new reporting regime is intended to assist the Financial Stability Oversight Council in monitoring risk to the U.S. financial system. Advisers with assets under management of \$1 billion or more must submit their reports within 15 days of the end of each reporting period.

The CFTC has also proposed to (i) reinstate futures trading and marketing restrictions for mutual funds and (ii) rescind the exemptions from CPO registration relied upon by most hedge fund managers, among other proposed changes that would impact CPOs and CTAs. Comments on the proposed rules are due by April 12, 2011.

**I. PRIVATE FUND SYSTEMIC REPORTING****FORM PF**

The jointly proposed rules would require each investment adviser that is registered or is required to register with the SEC as an investment adviser and that manages one or more private funds to file Form PF with the SEC.<sup>2</sup> Such private fund advisers would be divided into two groups on the basis of assets under management (“AUM”) for purposes of determining the amount and frequency of information required to be reported by the adviser on Form PF. Under the proposed rules, Form PF filings would remain confidential. It is important to note that only the first two sections of Form PF are being jointly proposed. Thus, they are the only Form PF sections relevant to dual registrants.

**FORMS CPO-PQR AND CTA-PR**

In addition to the jointly proposed rules concerning Form PF, the CFTC proposed new rules<sup>3</sup> to require each commodity pool operator (“CPO”) and commodity trading advisor (“CTA”) that is registered or required to register with the CFTC to file the proposed Forms CPO-PQR and CTA-

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<sup>1</sup> The rules implement certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).

<sup>2</sup> Joint Proposed Rule; Proposed Interpretations: Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, 76 Fed. Reg. 8068 (Feb. 11, 2011).

<sup>3</sup> Proposed Rule; Proposed Interpretations: Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 76 Fed. Reg. 7976 (Feb. 11, 2011).

PR, respectively. Similar to Form PF, the amount of information required to be disclosed on the forms will vary depending on the size of the operator or advisor and the size of the advised pools. The CFTC has also proposed to amend Rule 145.5 to ensure that certain proprietary information collected pursuant to proposed Forms CPO-PQR and CTA-PR will remain confidential.

Dual registrant CPOs and CTAs could satisfy certain of the proposed CFTC filing requirements by filing Form PF with the SEC. Private fund advisers that are dually registered would be required to file Schedule A on the applicable CFTC form. Dual registrants that operate or advise commodity pools that do not fall within the definition of “private fund” would be required to file the proposed CFTC forms in their entirety.

### **LARGE PRIVATE FUND ADVISERS**

“Large private fund advisers” would include those advisers that, along with their related persons, had at least \$1 billion of AUM in private funds as of the close of business on any day during the reporting period. Large private fund advisers would be required to report basic information about their operations as well as additional systemic risk-related information on a quarterly basis. The information required by the report would depend on the type of private funds managed by the adviser. The agencies propose an initial filing deadline for large hedge fund advisers of January 15, 2012 for the quarter ended December 31, 2011.

Large hedge fund advisers would report information regarding the market value of aggregate assets invested (on a short and long basis) in different types of securities and commodities, the duration of fixed income portfolio holdings, the turnover rate of the adviser’s aggregate portfolios and a geographic breakdown of investments held by each hedge fund advised. In addition, an adviser to a hedge fund having a net asset value greater than \$500 million would be required to report certain information relating to that fund’s portfolio liquidity, concentration, leverage and significant counterparties.

Advisers to large liquidity funds (*e.g.*, unregistered money market funds) would be required to provide information on the types of assets held by such liquidity funds, as well as certain information relevant to the risk profile of the fund and the extent to which the fund has a policy of complying with some or all aspects of the rules applicable to registered money market funds under the Investment Company Act of 1940 (the “1940 Act”).

Large private equity fund advisers would be required to report information about each fund’s borrowings and guarantees, the leverage of certain portfolio companies controlled by each fund and information regarding any financial industry portfolio company.

### **SMALLER PRIVATE FUND ADVISERS**

“Smaller private fund advisers” are proposed to include advisers registered or required to be registered with the SEC that advise private funds with less than \$1 billion in AUM. Unlike large private fund advisers, smaller private fund advisers would be required to file Form PF once a

year and report only basic information about their funds. This information includes identifying information about the adviser, basic aggregate information about the private funds managed, information about the fund's borrowings, reporting of the fund's gross and net assets, and the aggregate notional value of derivative positions. Small hedge fund advisers would also be required to report information about investment strategies, significant trading counterparty exposures, and trading and clearing practices.

Form PF filings for advisers to smaller private funds would be due 90 days after the end of the fiscal year to which they relate. The initial Form PF for funds with a December 31 fiscal year would be due by March 31, 2012.

## **II. SYSTEMIC RISK REPORTING FOR CERTAIN COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS**

Proposed CFTC Rule 4.27 would require CPOs and CTAs to file with the National Futures Association ("NFA") reports regarding their funds or accounts either quarterly or annually. CPOs with AUM equal to or greater than \$1 billion would be required to file Form CPO-PQR within 15 days of the end of each quarter. CPOs with AUM equal to or exceeding \$150 million but less than \$1 billion ("mid-sized CPOs") would be required to file certain information quarterly and other information within 90 days of the end of each calendar year. CTAs would be required to file Form CTA-PR within 15 days of the end of each quarter.

The proposed CFTC forms are substantively similar to Form PF, as are the threshold requirements of assets under management regarding disclosure of information and proposed timing deadlines for the filings. The proposed rules are anticipated to become effective six months after the adoption of the proposed forms.

### **COMMODITY POOL OPERATORS**

CPOs with AUM equal to or greater than \$150 million would be required to disclose detailed information for all operated pools, including information regarding each pool's investment strategy, borrowings by geographic area, and the identities of significant creditors, credit counterparty exposure and entities through which the pool trades and clears its positions.

CPOs with AUM equal to or greater than \$1 billion ("large CPOs") would also be required to disclose aggregate information regarding their commodity pools, such as the market value of assets invested, on both a long and short basis, in different types of securities and derivatives, turnover in these categories of financial instruments and the tenor of fixed income portfolio holdings. Additionally, large CPOs that advise a commodity pool with a NAV exceeding \$500 million would be required to also report certain additional information with respect to such a pool, including a geographic breakdown of the reportable pool's assets, and information regarding asset liquidity, concentration of positions, material investment positions, collateral practices with significant counterparties, and clearing relationships.

## Summary of proposed CPO filing requirements:

	Form PF	PQR Schedule A	PQR Schedule B	PQR Schedule C
Dual Registrant CPO for Private Funds Only (AUM equal to or exceeding \$1 billion)	Quarterly	Quarterly		
Dual Registrant CPO for Private Funds Only (AUM less than \$1 billion)	Annually	Quarterly		
Large CPO – Not Dually Registered (AUM equal to or exceeding \$1 billion)		Quarterly	Quarterly	Quarterly
Mid-Sized CPO – Not Dually Registered (AUM equal to or exceeding \$150 million but less than \$1 billion)		Quarterly	Annually	
Small CPO – Not Dually Registered (AUM less than \$150 million)		Quarterly		

**COMMODITY TRADING ADVISORS**

All CTAs would be required to disclose general information about the CTA and commodity pool AUM on a quarterly basis. CTAs with commodity pool AUM equal to or exceeding \$150 million (mid-size and large CTAs), would be required to disclose details of the CTA’s trading program(s), including the position, performance, and a description of the trading strategy for each trading program.

## Summary of proposed CTA filing requirements:

	Form PF	PR Schedule A	PR Schedule B
Dual Registrant CTA (AUM equal to or exceeding \$1 billion)	Quarterly	Quarterly	
Dual Registrant CTA (AUM less than \$1 billion)	Annually	Quarterly	
Large and Mid-Sized CTAs – Not Dually Registered		Quarterly	Quarterly
Small CTA – Not Dually Registered (AUM less than \$150 million)		Quarterly	

**EFFECT OF CFTC REPORTING REQUIREMENTS ON NFA RULE 2-46 REPORTING REQUIREMENTS**

NFA Compliance Rule 2-46 requires each CPO subject to CFTC financial reporting requirements to file certain information regarding each such pool on a quarterly basis. Certain of the information required on Forms PF and CPO-PQR would be duplicative of information currently filed pursuant to Rule 2-46.

Under the CFTC’s proposed Form CPO-PQR, CPOs must file within 15 days of the end of each quarter, rather than 45 days as currently required by Rule 2-46. Additionally, CPOs would be required to provide a schedule of investments identifying any investment that exceeds 5% of the pool’s NAV, rather than each 10% investment as required by Rule 2-46.

### III. AMENDMENTS TO CPO AND CTA REGISTRATION AND COMPLIANCE REQUIREMENTS

The CFTC has also proposed amendments to certain CPO and CTA registration requirements and compliance obligations. Specifically, the CFTC proposes to (i) reinstate trading and marketing restrictions for registered investment companies relying on Rule 4.5; (ii) rescind the exemptions from CPO registration provided by CFTC Rules 4.13(a)(3) and (a)(4); (iii) require annual reports for Rule 4.7 funds to be audited; (iv) require annual confirmation of notices of claims of exemption; (v) require a new risk disclosure statement regarding swap transactions; and (vi) make other conforming changes.

#### A. Registered Investment Companies Excluded from the Definition of CPO.

The proposed amendment to Rule 4.5 would subject registered investment companies to CFTC and NFA disclosure rules and oversight if they are marketed as vehicles for trading in or seeking exposure to the futures or options markets, even though they are also subject to SEC oversight.

Currently, certain otherwise regulated persons, including investment companies registered under the 1940 Act, regulated insurance companies and banks and pension plans, are excluded from the definition of CPO under Rule 4.5 with regard to their operation of specified trading vehicles. Rule 4.5 entities are not required to register with the CFTC or become members of the NFA and comply with disclosure, reporting and recordkeeping requirements.

For many years, Rule 4.5 limited the level of speculative futures trading and prohibited marketing the qualifying entity as a futures trading vehicle. In August 2003, however, the CFTC eliminated these trading and marketing limitations. Thus, Rule 4.5 entities are presently 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 proposed amendments would reinstate the old Rule 4.5 language only with respect to registered investment companies, but with a notable exception. In order to rely on Rule 4.5, an investment company would be required to represent that the 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 pre-2003 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 independently satisfies the requirements of Rule 4.5.

The proposed amendments would also reinstate the marketing restrictions that were in the pre-2003 version of Rule 4.5. Specifically, if the changes to the rule are adopted as proposed, 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.” The “no marketing” condition is separate from, and in addition to, the speculative trading limitation and it could be read to encompass mutual funds that seek commodity exposure indirectly through the use of swaps or structured notes.

## **B. Rescission of CPO Registration Exemptions.**

The CFTC has proposed to eliminate the registration exemptions relied upon by many hedge fund managers. Repeal of CFTC Rules 4.13(a)(3) and 4.13(a)(4) would generally require each fund's CPO to register with the CFTC and become a member of the NFA, regardless of how little futures trading a pool employs or the sophistication level of the pool's investors. Consequently, many hedge fund managers that operate pools that trade only a *de minimis* amount of futures or whose investors are highly sophisticated (e.g., qualified purchasers) could be required to register with the CFTC.

Currently, Rule 4.13(a)(3) exempts from registration the CPO of a commodity pool that trades only a *de minimis* amount of futures. Trading must be limited so that at all times (i) no more than 5% of the fund's liquidation value is committed to futures, or (ii) the aggregate net notional value of futures and options positions does not exceed 100% of the liquidation value of the pool's portfolio. Many CPOs rely on this exemption with respect to so-called 3(c)(1) funds, which are excluded from the definition of investment company by the 1940 Act as a result of having not more than 100 beneficial owners.

Rule 4.13(a)(4) provides an exemption from registration for the CPO of a pool sold only to sophisticated investors, such as qualified purchasers. Rule 4.13(a)(4) does not impose any limit on the level of futures trading in which the pool may engage. Many CPOs rely on this exemption with respect to so-called 3(c)(7) funds, which are excluded from the definition of investment company by the 1940 Act due in part to the sophistication of their investors.

## **C. Certification Requirement for Rule 4.7 Annual Reports.**

Currently, annual financial statements of pools operated pursuant to CFTC Rule 4.7 are not required to be certified by an independent public accountant. The CFTC has proposed to eliminate this reporting relief and would require all Rule 4.7 commodity pool annual reports to be certified.

## **D. Annual Filings to Reaffirm Claims of Exemption.**

Currently, no specific requirement exists for exempt or excluded entities to reaffirm their status or inform the CFTC if and when they cease operations.

The CFTC has proposed to require all persons claiming exemptive or exclusionary relief to confirm their notice of claim of exemption or exclusion on an annual basis. Failure to comply with the annual notice requirement would be treated as a request to withdraw the exemption or exclusion.

**E. Swap Risk Disclosure Statement.**

The Dodd-Frank Act expanded the CFTC's authority to regulate swaps. As part of implementing its new authority, the CFTC has proposed a swap risk disclosure statement. Consequently, CPOs and CTAs will be required to include disclosures specific to swaps in offering documents delivered to pool participants and disclosure documents delivered to CTA clients.

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If you have any questions concerning the matters described in this memorandum, please contact Daniel Schloendorn (212-728-8265, dschloendorn@willkie.com), Rita M. Molesworth (212-728-8727, rmolesworth@willkie.com), Joseph P. Cunningham (212-728-8161, jcunningham@willkie.com), Deborah A. Tuchman (212-728-8491, dtuchman@willkie.com), Gabriel Acri (212-728-8833, gacri@willkie.com), Mark A. Vandehaar (212-728-8720, mvandehaar@willkie.com), or the Willkie attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099 and has an office located at 1875 K Street, NW, Washington, DC 20006-1238. Our New York telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our Washington, D.C. telephone number is (202) 303-1000 and our facsimile number is (202) 303-2000. Our website is located at [www.willkie.com](http://www.willkie.com).

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