

SURVEY OF CFTC RELIEF

Commodity Futures Trading Commission staff has issued several no-action and interpretative letters providing relief from certain regulatory requirements otherwise applicable to, among others, the sponsors of collective investment vehicles. Some relief is permanent, while some is temporary. Highlights of these letters follow.

I. Background

The Dodd-Frank Act¹ expanded the definition of “commodity interest” to include swaps² (including mixed swaps, but excluding security-based swaps and certain foreign exchange swaps and forwards). Additionally, the CFTC promulgated certain amendments to Part 4 of its regulations in February 2012, including the rescission of Regulation 4.13(a)(4).³ As a result of these changes, many individuals and entities who previously were not subject to CFTC regulations – including, but not limited to, the requirement to register with the CFTC as a commodity pool operator (“CPO”) and/or a commodity trading advisor (“CTA”) – are now required to comply with such regulations.

CPOs that were previously not required to register with respect to the operation of commodity pools pursuant to Regulation 4.13(a)(4) now must either: (1) register with the CFTC, obtain membership in National Futures Association (“NFA”) and operate such commodity pools in conformance with the CFTC’s Part 4 rules; or (2) file for relief under Regulation 4.13(a)(3) with respect to each such commodity pool and ensure each is in compliance with the requirements of Regulation 4.13(a)(3), including the requirement that the commodity pool’s trading in commodity interests (including on a look-through basis) be below certain *de minimis* thresholds.

Additionally, due to the expanded definition of commodity interest, many entities that previously were not CPOs now are considered to be operating commodity pools. The staff of the CFTC has

¹ The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

² See Section 721(a) of the Dodd-Frank Act. The term “swap” is broadly defined and includes, but is not limited to, (i) options, such as puts, calls, caps, and floors on most reference assets, (ii) swaps on interest rates, broad-based securities indices, and other reference assets, (iii) credit default swaps, (iv) any other instrument that becomes commonly known as a swap and (v) foreign currency swaps and non-deliverable forward contracts.

A “security-based swap” includes, but is not limited to, a swap on (i) a narrow-based security index, (ii) a single security or loan, or (iii) the occurrence or non-occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial obligations, or financial condition of the issuer.

³ See “Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations,” 77 FR 11252 (Feb. 24, 2012); correction 77 FR 17328 (March 26, 2012).

provided guidance regarding the application of these changes to certain situations and investment vehicles, and in certain cases relief from the application of particular regulatory requirements. CFTC staff has generally conditioned such relief on market participants' acting reasonably and in good faith in progressing to full compliance with the Commodity Exchange Act ("CEA") and CFTC regulations.

II. Relief for Certain Instruments

Compo equity total return swaps may be treated as security-based swaps.

- Time-limited no-action relief, through June 30, 2013, permits a compo equity total return swap to be treated as a security-based swap and not as a mixed swap.
- As a result of this relief, through June 30, 2013, compo equity total return swaps do not have to be included in the numerator for purposes of determining compliance with the *de minimis* thresholds of Regulations 4.13(a)(3) and 4.5.

III. Relief for Certain Vehicles

Certain securitization vehicles excluded from definition of commodity pool.

- Securitization vehicles that issue asset-backed securities (including mortgage-backed securities) will not be included within the definition of "commodity pool," and their operators will not be included within the definition of "commodity pool operator," provided that the following conditions are satisfied:
 - the use of swaps (and other derivatives) is no greater than that contemplated by Regulation AB⁴ and Rule 3a-7⁵ of the Investment Company Act of 1940 (the "1940 Act"), and such swaps are not used in any way to create an investment exposure;
 - the entity's activities are limited to passively owning or holding a pool of receivables or other financial assets that by their terms convert to cash within a finite time period;
 - the issuer makes payments to securities holders only from cash flow generated by its vehicle assets, and not from, or otherwise based upon, changes in the value of the entity's assets; and
 - the issuer is not permitted to acquire additional assets or dispose of assets for the primary purpose of realizing gain or minimizing loss due to changes in market value of the vehicle's assets.

⁴ 17 CFR 229.1100 *et seq.*

⁵ 17 CFR 270.3a-7.

No-action relief for operators of and investors in certain securitization vehicles.

- CFTC staff provided no-action relief from the CPO registration requirement for any operator of a securitization vehicle that was formed prior to October 12, 2012 and has not and will not issue new securities on or after October 12, 2012 (a “legacy securitization vehicle”), even if such legacy securitization vehicle does not meet the conditions for exclusion from the definition of commodity pool outlined above.
- This no-action relief extends to operators of funds that invest in such legacy securitization vehicles.
- The CFTC staff also extended the deadline for CPO registration for operators of all other securitization vehicles to March 31, 2013.

Equity real estate investment trusts excluded from definition of commodity pool.

- Equity real estate investment trusts (“eREITs”) will not be included within the definition of “commodity pool,” and the operator of any eREIT will not be included within the definition of “commodity pool operator,” provided that the following conditions are satisfied:
 - the eREIT primarily derives its income from the ownership and management of real estate and uses derivatives for the limited purpose of mitigating exposure to changes in interest rates or fluctuations in currency;
 - the eREIT is operated so as to comply with all of the requirements of a REIT election under the Internal Revenue Code; and
 - the eREIT has identified itself (or has disclosed to its shareholders that it intends to identify itself) as an eREIT in Item G of its U.S. income tax return on Form 1120-REIT and continues to qualify as such.

No-action relief for operators of mortgage real estate investment trusts.

- CFTC staff provided no-action relief from the CPO registration requirement for any operator of a mortgage real estate investment trusts (“mREITs”), provided that the following conditions are satisfied:
 - the mREIT limits the initial margin and premiums required to establish its commodity interest positions to no more than 5% of the fair market value of the mREIT’s total assets;
 - the net income derived annually from the mREIT’s commodity interest positions that are not qualifying hedging transactions is less than 5% of the mREIT’s gross income;

- interests in the mREIT are not marketed to the public as or in a commodity pool or otherwise as or in a vehicle for trading in commodity interests; and
 - the company has identified itself (or has disclosed to its shareholders that it intends to identify itself) as an mREIT in Item G of its U.S. income tax return on Form 1120-REIT and continues to qualify as such.
- In order to perfect the no-action relief, a CPO that is eligible must file a claim with the Division of Swap Dealer and Intermediary Oversight (the “DSIO”) within 30 days after the mREIT begins to operate.

No-action relief for operators of business development companies.

- CFTC staff provided no-action relief from the CPO registration requirement for any operator of a business development company (“BDC”), provided that the following conditions are satisfied:
 - the BDC has elected to be treated as a BDC under Section 54 of the 1940 Act, and continues to be regulated as such by the Securities Exchange Commission (“SEC”);
 - the BDC will not be, and has not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in commodity interests; and
 - either (a) the BDC uses commodity interests solely for bona fide hedging purposes; provided, however, that in addition, with respect to positions in commodity interests that do not qualify as bona fide hedges, the aggregate initial margin and premiums required to establish such positions do not exceed 5% of the liquidation value of the BDC’s portfolio; or (b) the aggregate net notional value of commodity interest positions not used solely for bona fide hedging purposes, determined at the time the most recent position was established, does not exceed 100% of the liquidation value of the BDC’s portfolio.
- In order to perfect the no-action relief, a CPO that is eligible must file a claim with the DSIO within 30 days after the BDC begins to operate.

No-action relief for operators of family offices.

- CFTC staff provided no-action relief from the CPO registration requirement for operators of “family offices” as that term is defined under SEC Rule 202(a)(11)(G)-1.
- In order to perfect the no-action relief, a family office operator must file a claim with the DSIO within 30 days after the family office begins to operate.

Time-limited no-action relief for operators of funds of funds (no longer available).

- CFTC staff provided time-limited no-action relief from the CPO registration requirement for operators of funds of funds until the later of June 30, 2013 or six months from the date that the DSIO issues revised guidance on the application of the calculation of *de minimis* thresholds in the context of Regulations 4.5 and 4.13(a)(3).
 - CFTC staff provided such time-limited no-action relief to any CPO of a fund of funds that submitted a claim to the DSIO prior to December 31, 2012.

IV. Relief from Certain Associated Person, Principal and Other Registration Requirements

No-action relief for non-U.S. principals.

- CFTC staff provided no-action relief from the fingerprinting requirement under Regulation 3.10(a)(2) for principals of CFTC registrants where the principal has not resided in the United States since reaching 18 years of age (“Non-U.S. Principal”).

Time-limited no-action relief for certain associated persons.

- CFTC staff provided time-limited no-action relief from the requirement to be registered as an AP of a futures commission merchant (“FCM”), IB, CPO or CTA, where the requirement to be registered as such arises solely from the swaps activity of the person or from the person being involved with the transition of certain contracts by the Intercontinental Exchange, Inc. and the New York Mercantile Exchange to clearing as commodity futures and options transactions. The relief is conditioned on the FCM, IB, CPO or CTA completing and filing with NFA an AP registration application for the person, including a Form 8-R and fingerprint card, no later than March 31, 2013.

No-action relief for certain affiliates of swap dealers and swap counterparties and their employees.

- CFTC staff provided no-action relief from the requirement to register as an introducing broker (“IB”) or a CTA for any affiliate of a swap dealer (and its employees) that engages in certain support activities in connection with a swap transaction to be entered into by such swap dealer and such affiliate as counterparties, provided that the following conditions are satisfied:
 - the swap dealer and the affiliate counterparty are “majority-owned affiliates” as described in Regulation 1.3(ggg)(6);
 - the employee is an associated person (“AP”) of the swap dealer, as defined in Regulation 1.3(aa)(6), and neither the employee nor any person in the supervisory chain of command of the employee is subject to a statutory disqualification from registration;

- the swap dealer and the employee provide commodity interest trading advice in a manner solely incidental to the conduct of the business of the swap dealer as a swap dealer;
- neither the swap dealer nor the employee is otherwise engaged in activity that would require registration as an IB, CTA or AP thereof; and
- the swap dealer and affiliate counterparty execute in writing an undertaking by which they each agree to be jointly and severally liable for any violation of the CEA or CFTC regulations by any employee of the swap dealer engaged in any affiliate support activity on behalf of the affiliate counterparty.

In addition to the foregoing no-action and interpretative letters issued by the CFTC staff, the DSIO responded to concerns that NFA may not be able to timely process registration filings due to the large number of such filings required as a result of the rescission of Regulation 4.13(a)(4) and amendment to Regulation 4.5. The DSIO stated that it would not recommend that the CFTC take enforcement action against CPOs, CTAs, and the principals and APs thereof, who are required to register as a result of such rule changes for engaging in CFTC regulated activities prior to registration, provided that any such person applied for the appropriate registration by December 31, 2012. The CFTC staff further provided that any person relying on such relief is required to comply with the CEA and CFTC's regulations applicable to the person's activities, as if the person was in fact registered.

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If you have any questions concerning the foregoing or would like additional information, please contact Rita M. Molesworth (212-728-8727, rmolesworth@willkie.com), Deborah A. Tuchman (212-728-8491, dtuchman@willkie.com), Jonathan C. Burwick (212-728-8108, jburwick@willkie.com), Devon S. Sharma (212-728-8622, dsharma@willkie.com), or the Willkie attorney with whom you regularly work.

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