CFTC Adopts Harmonization Rules for Investment Advisers that are Commodity Pool Operators of Registered Funds

By Cary J. Meer, Mark C. Amorosi, Lawrence B. Patent, Susan Gault-Brown, Leeron Avnery, Mary K. Clarke-Pearson and Craig A. Ruckman

Overview

On August 13, 2013, the Commodity Futures Trading Commission (“CFTC”) adopted long-awaited harmonization rules (“Harmonization Rules”) for operators of registered investment companies (“Registered Funds”) that are subject to registration as commodity pool operators (“CPOs”). The Harmonization Rules address regulatory issues that Registered Fund operators and Registered Funds face under dual regulation by the CFTC and the Securities and Exchange Commission (“SEC”). The need for harmonization measures followed from the CFTC’s adoption in 2012 of amendments to CFTC Regulation 4.5 that require the operators of Registered Funds to either limit such Registered Funds’ use of futures contracts, options on futures contracts, leverage contracts, retail forex contracts, and swaps (together, “commodity interests”) or register as CPOs and submit to dual regulation by the CFTC and the SEC. In amending Regulation 4.5, the CFTC recognized that CFTC and SEC requirements for dual registrants required harmonization because many of them are duplicative or inconsistent.

Under the Harmonization Rules, the CFTC generally will accept the SEC’s disclosure, reporting, and recordkeeping regime as “substituted compliance” for substantially all of the CFTC’s Part 4 regulations (subject to some exceptions) as long as the CPO of the Registered Fund (“Registered Fund CPO”) complies with applicable requirements under the SEC’s statutory and regulatory compliance regime to which it or the Registered Fund is already subject. The CFTC also amended certain provisions of its Part 4 regulations that are applicable to all CPOs to provide relief similar to that provided to Registered Fund CPOs.

On the day following the CFTC’s adoption of the Harmonization Rules, in what appears to be a coordinated action, the SEC’s Division of Investment Management published an “Investment Management Guidance Update” summarizing SEC staff views regarding certain disclosure and compliance requirements for Registered Funds that invest in commodity interests. The IM Guidance largely reiterates past SEC staff guidance and emphasizes the importance of complete, accurate and current disclosure regarding Registered Fund investment strategies and risks related to use of commodity interests, as well as robust supporting compliance policies. The IM Guidance is intended to provide guidance for the CPOs of such Registered Funds following the Harmonization Rules and to clarify the SEC’s position on certain issues raised by the CFTC’s amendments.

to assist Registered Fund CPOs that comply with certain Harmonization Rule requirements in also remaining in compliance with SEC requirements.

**Summary of Harmonization Rules**

Under the Harmonization Rules, a Registered Fund CPO may comply with the CFTC’s Part 4 regulations applicable to all CPOs or elect, pursuant to an amended Regulation 4.12(c), to comply with SEC requirements through substituted compliance, subject to certain conditions. A Registered Fund CPO claiming the substituted compliance exemption must file with the National Futures Association (“NFA”) a notice of its use of the substituted compliance regime outlined in Regulation 4.12(c). CPOs that registered as such with respect to existing Registered Funds as a result of the amendments to Regulation 4.5 must have filed the notice by the compliance date, October 21, 2013. Those claiming this relief may avail themselves of the following significant exemptions, which are discussed in detail following this summary:

- **Disclosure Exemptions** – Regulation 4.12(c) provides a broad exemption from the CFTC’s Disclosure Document requirements in Regulations 4.21, 4.24, 4.25 and 4.26, provided that:
  - The disclosure provided with respect to the Registered Fund complies with the provisions of the Investment Company Act of 1940 (“Investment Company Act”), the Securities Act of 1933 (“Securities Act”), the Securities Exchange Act of 1934 and the rules thereunder, and any guidance issued by the SEC or its staff; and
  - The CPO of a Registered Fund with less than a three-year operating history discloses (presumably in the Registered Fund’s prospectus) the performance of all accounts and pools that are managed by the CPO and that have investment objectives, policies and strategies substantially similar to those of the Registered Fund. (See discussion below regarding the IM Guidance’s statements relating to implementing this requirement.)

- **Reporting Exemptions** – Regulation 4.12(c) provides an exemption from the monthly Account Statement preparation and distribution requirements of Regulations 4.22(a) and (b), provided that:
  - The Registered Fund CPO causes the current net asset value per share of the Registered Fund to be available to shareholders; and
  - The Registered Fund CPO causes the Registered Fund to disclose that its net asset value will be readily accessible on an Internet website maintained by the CPO or its designee or otherwise made available to shareholders and to disclose the means through which the net asset value will be made available, including the Internet address of the Internet website, if applicable.

- **Recordkeeping Relief** – Regulation 4.12(c), together with other rule amendments adopted by the CFTC, permits Registered Fund CPOs to maintain books and records with certain third parties, rather than exclusively at the CPO’s main office, provided that the CPO files a notice with the NFA of its intent to use third party service providers for recordkeeping purposes.

The relief provided by the Harmonization Rules generally is available to operators of any investment company that is registered under the Investment Company Act. However, as discussed in more detail below, the CFTC also adopted other rule amendments that provide relief to all CPOs.

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5 Regulations 4.21, 4.24, 4.25 and 4.26 generally require a CPO to prepare and deliver to participants in each pool that it operates a current Disclosure Document that includes the disclosures required by these regulations.

6 Regulations 4.22(a) and (b) generally require a CPO to prepare and deliver to participants in each pool that it operates a monthly Account Statement that includes a Statement of Operations and a Statement of Changes in Net Assets.
Disclosure Harmonization

A. Disclosure Exemptions

The Harmonization Rules provide Registered Fund CPOs with the option either to comply with the Disclosure Document content and delivery requirements in the Part 4 regulations or rely upon the substituted compliance exemption from these requirements in amended Regulation 4.12(c), as summarized above. Importantly, the substituted compliance exemption requires Registered Fund CPOs to comply with all of the disclosure requirements of the federal securities laws applicable to Registered Funds. This means that any failure to meet those requirements creates potential exposure not only to an SEC enforcement action, but also to a CFTC enforcement action for failure to comply with its Part 4 requirements. In addition, Regulation 4.12(c) does not include any materiality threshold and extends the compliance requirement not only to statutes and regulations administered by the SEC but also to SEC and staff interpretive guidance.

The following paragraphs briefly summarize certain significant disclosure exemptions for Registered Fund CPOs that elect to rely on amended Regulation 4.12(c):

1. Fee Disclosure. Under the Harmonization Proposal, the CFTC would have required Registered Fund CPOs to include the break-even table required by Regulation 4.24(d)(5) and the narrative fee disclosure required by Regulation 4.24(i). The Harmonization Rules provide an exemption for Registered Fund CPOs from the fee disclosure requirements in the CFTC’s Part 4 regulations. Consequently, Registered Fund CPOs will be deemed compliant with the CFTC’s fee disclosure requirements provided that the Registered Fund CPO complies with applicable SEC disclosure requirements, even if the Registered Fund CPO does not include the break-even table or other CFTC-required fee disclosures.

2. Risk Statements and Legends. Under the Harmonization Proposal, the CFTC would have required Registered Fund CPOs to include the Cautionary Statement required by Regulation 4.24(a) and the Risk Disclosure Statements required by Regulation 4.24(b). Under the final Harmonization Rules, Registered Fund CPOs are not required to include these disclosures, and instead are permitted to include a reference to the CFTC in the existing statement prescribed by the SEC under Securities Act Rule 481. In the IM Guidance, the SEC staff confirmed that it would not object if a Registered Fund that invests in commodity interests includes in the required Rule 481 legend language that also indicates that the CFTC has not approved or disapproved of the securities or passed upon the accuracy or adequacy of the disclosure in the prospectus.

3. Principal Risk Factors. The Harmonization Proposal also would have required Registered Fund CPOs to comply with the other risk disclosure requirements in Regulation 4.24(g). Amended Regulation 4.12(c) exempts Registered Fund CPOs from these requirements, subject to compliance with SEC disclosure requirements, stating that “the disclosure requirements on SEC forms N-1A and N-2, consistent with guidance from SEC staff…should satisfy the [CFTC]’s concern that participants receive complete and accurate disclosure about the risks associated with investment in commodity interests.” In the IM Guidance, the SEC staff emphasized the following points with respect to disclosure regarding the use of derivatives: (1) all Registered Funds that use or intend to use derivative instruments should assess the accuracy and completeness of their disclosure, including whether the disclosure is presented in an understandable manner using plain English; (2) any principal investment strategies and principal risk disclosure related to derivatives should be tailored specifically to how a Registered Fund expects to be managed, the types of derivatives used by the Registered Fund, and the extent and purpose of their use; and (3) Registered Funds should assess on an ongoing

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7 The CFTC stated, for example, that the statement could read as follows: The Securities and Exchange Commission and the Commodity Futures Trading Commission have not approved or disapproved these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.
basis the completeness and accuracy of the derivatives-related disclosures in their registration statements in light of their actual operations.

4. Performance Disclosure. Under the Harmonization Proposal, Registered Fund CPOs generally would have been required to disclose, under certain circumstances, prior performance of all other pools and accounts managed by the CPO and the Registered Fund’s CTA(s). In both the Harmonization Proposal and the Harmonization Adopting Release, the CFTC acknowledged that this requirement conflicts with SEC staff guidance, which permits Registered Funds to disclose performance information for other funds and accounts only if those funds and accounts are managed with substantially similar investment objectives, policies, and strategies as the Registered Fund.\(^8\) In response to comments, the CFTC agreed to exempt Registered Funds from the performance disclosure requirements of Regulations 4.24 and 4.25, except that a CPO operating a Registered Fund with less than three years operating history will be required to disclose, presumably in its prospectus,\(^9\) information concerning pools or accounts that are managed by the CPO and that have substantially similar investment objectives, policies and strategies.

The IM Guidance indirectly acknowledged this requirement and reminded registrants that, if the registration statement for a Registered Fund includes information concerning the performance of private accounts or other funds managed by the Registered Fund’s adviser, the Registered Fund is responsible for ensuring that the information is not materially misleading. It also states the expectation that “a fund that includes the performance of other funds or private accounts managed by the fund’s adviser in its registration statement would generally include the performance of all other funds and private accounts managed by the adviser that have investment objectives, policies, and strategies substantially similar to those of the fund.” The IM Guidance cautions that “a fund should not exclude the performance of any other funds or private accounts that have substantially similar investment objectives, policies, and strategies if the exclusion would cause the performance shown to be materially higher or more favorable than would be the case if the funds or accounts were included. A fund should only exclude funds or private accounts if the exclusion would not cause the performance to be materially misleading.”

B. Effective Time Period for Disclosure Documents

Under prior CFTC rules, a CPO or CTA could not use a Disclosure Document dated more than nine months prior to the date of its use.\(^10\) In the Harmonization Adopting Release, the CFTC acknowledged that CPOs and CTAs could realize efficiencies if the updating requirements of the Part 4 regulations were aligned with the time period mandated for filing annual financial statements. As a result, the Harmonization Rules amended CFTC Regulations 4.26 and 4.36 to permit all CPOs and CTAs to use a Disclosure Document for up to 12 months.

The CFTC noted, however, that the federal securities laws require a Registered Fund’s registration statement to be updated annually within four months after the end of the Registered Fund’s fiscal year.\(^11\) Thus, a Registered Fund using a registration statement that contains information up to 16 months old in compliance with SEC requirements could be subject to incongruent timeframes under the CFTC and SEC regimes for the regular updating of disclosure documents. To alleviate this potential conflict, amended Regulation 4.12(c) provides that a Registered Fund CPO is in compliance with CFTC Regulation 4.26(a) if the CPO updates the Registered Fund’s registration statement consistent with the requirements of Section 10(a)(3) of the Securities Act and Rule 485 thereunder.

\(^8\) See, e.g., Nicholas-Applegate Mutual Funds, SEC No-Action Letter (Aug. 6, 1996).
\(^9\) IM Guidance at 3.
\(^10\) CFTC Regulations 4.26(a)(2) and 4.36(b).
\(^11\) See Section 10(a)(3) of the Securities Act and Rule 485 thereunder.
C. Off-Cycle Updates of Disclosure Documents

A CPO must correct any incompleteness or material inaccuracy in its Disclosure Document of which it becomes aware and distribute the correction to participants within 21 calendar days in order to provide participants with timely corrected information. By comparison, the federal securities laws prohibit the offer or sale of a security by means of a materially misleading prospectus and impose liability for the use of such a prospectus. Consistent with this end, the SEC has adopted a regime for updating registration statements, including the timing and distribution of such updates. In the Harmonization Adopting Release, the CFTC observed that the goal of the federal securities laws of providing investors accurate information in a timely manner is consistent with the CFTC’s regulations, and that the schedule for updating a registration statement imposed by the SEC does not impair the CFTC’s regulatory interest. As a result, under the Harmonization Rules, the CFTC will deem a Registered Fund CPO to be in compliance with CFTC Regulation 4.26(c) if it complies with the regulatory regime administered by the SEC.

D. NFA Filing and Review Requirements

CPOs currently must submit all Disclosure Documents to the NFA at least 21 calendar days prior to distributing the document to participants and submit updates to Disclosure Documents to the NFA to correct material inaccuracies or incompleteness within 21 calendar days of becoming aware of the defects. Similarly, a Registered Fund must file a registration statement, and any amendments thereto, with the SEC. However, the review timeframes for a registration statement and a Disclosure Document under Part 4 are different. Under the Harmonization Rules, the CFTC will deem Registered Fund CPOs compliant with the disclosure review provisions of CFTC Regulation 4.26(d) if they are in compliance with the regulatory regime administered by the SEC. In addition, the CFTC clarified that all disclosure documents must be made available to NFA during the course of an examination, but Registered Fund CPOs will not be required to file such disclosure documents with NFA according to the schedules provided in CFTC’s Part 4 regulations or concurrent with their filing with the SEC. Furthermore, those documents will not be subject to NFA approval. In order to rely on this relief, a Registered Fund CPO must file a notice with NFA claiming the relief.

E. Disclosure Document Delivery

Under the current rules, all CPOs are required to deliver a Disclosure Document to each prospective participant and to obtain from that prospective participant a signed acknowledgment of receipt of the Disclosure Document before accepting or receiving funds from that participant. Under the federal securities laws, a Registered Fund investor must receive a prospectus no later than the confirmation of the transaction. In addition, the federal securities laws do not impose a requirement that a Registered Fund investor provide a signed acknowledgement of receipt of the prospectus. An open-end Registered Fund is permitted to send or give a summary prospectus to an investor in satisfaction of its delivery obligations, provided generally that the statutory prospectus and other information are available on an Internet website. In the Harmonization Adopting Release, the CFTC observed that

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12 CFTC Regulation 4.26(c).
13 See, e.g., Section 12(a)(2) of the Securities Act.
14 See, e.g., Rule 485 under the Securities Act.
15 CFTC Regulation 4.26(d).
16 Section 8(a) of the Securities Act and Rule 485 thereunder. Whereas CFTC Regulation 4.26(d) imposes a 21-calendar day review period, an initial registration statement requires an order accelerating effectiveness following review by the SEC staff and is subject to the satisfactory completion of such review. Amendments to a registration statement may be subject to a review period of up to 60 days or more before becoming effective.
17 CFTC Regulation 4.21.
18 Section 5(b)(2) of the Securities Act.
19 See Securities Act Rule 498. Delivery of the summary prospectus satisfies a Registered Fund’s delivery obligations under Section 5 of the Securities Act, provided it meets the conditions of Rule 498. The statutory prospectus is the prospectus that meets the requirements of Section 10(a) of the Securities Act.
this regime requires that an investor receive substantial information about the Registered Fund, which is commensurate with the disclosure delivery provisions of CFTC Regulation 4.21. Accordingly, the CFTC will deem a Registered Fund CPO that complies with the SEC disclosure delivery requirements to be in compliance with CFTC Regulation 4.21. The CFTC further noted that it will deem any website that the SEC permits to be used to provide a statutory prospectus pursuant to SEC Rule 498 to be compliant with CFTC Regulation 4.21. Lastly, the CFTC also rescinded the signed acknowledgement requirement under CFTC Regulation 4.21(b) for all CPOs.

F. Impact on Use of Summary Prospectuses

A CPO is required to disclose information regarding the investment program, risks, fees, and performance information, among other items, in its pool’s Disclosure Document. Similarly, an open-end Registered Fund is subject to specific disclosure requirements regarding its investment objectives, policies, expenses and performance, among other items. As noted above, an open-end Registered Fund is permitted to use a summary prospectus, provided it satisfies certain conditions; however, the disclosure permitted in a summary prospectus is strictly limited and would not have accommodated any additional information required under the Part 4 regulations. Accordingly, under the Harmonization Rules, the CFTC will deem Registered Fund CPOs compliant with the provisions of CFTC Regulations 4.24 and 4.25, even if the information required thereunder is not included in the applicable summary prospectus, provided that they are in compliance with the disclosure requirements of the federal securities laws.

G. Treatment of Series Investment Companies

In the Harmonization Adopting Release, the CFTC addressed the disparate treatment of pools under its regime and that of the SEC. The SEC permits Registered Funds that are organized as series entities with inter-series limitations of liability to include multiple series in a single registration statement, with reporting and disclosure accomplished on a series-by-series basis. In contrast, the CFTC considers the pool to be the discrete legal entity and requires the pool to prepare Disclosure Documents at the legal entity level and not at the series level. Nonetheless, the CFTC acknowledged the substantial effort it would require for Registered Funds to comply with both regimes and asserted that, based on the substituted compliance approach of the Harmonization Rules, Registered Funds will continue to be able to construct their disclosure documents consistent with SEC guidance on series companies. Thus, a series company that complies with the substituted compliance approach under the Harmonization Rules will be deemed to be compliant with the CFTC’s requirements that disclosure documents be prepared at the entity level.

H. Treatment of Controlled Foreign Corporations

The CFTC also reaffirmed its position that Registered Funds may continue to use controlled foreign corporations (“CFCs”) to invest in commodity interests and that such CFCs may fall within the statutory and regulatory definitions of “commodity pool” depending on their investment activities. However, if the Registered Fund provides full disclosure of material information regarding the activities of its CFC, including the principal risks associated with the CFC and the underlying instruments in which the CFC invests, the CFC will not be required to separately prepare a Disclosure Document that complies with the CFTC’s Part 4 regulations. In addition, provided that the Registered Fund consolidates the financial statements of the CFC with those of the Registered Fund in the

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20 The CFTC also noted that CPOs are not required to maintain a current Disclosure Document for a pool if they are not soliciting participants for that pool; as a result, if a closed-end Registered Fund is operated consistent with its obligations under the federal securities laws, the CFTC will deem such a CPO to be compliant with the requirements of CFTC Regulation 4.21.
21 CFTC Regulations 4.24 and 4.25.
22 See Form N-1A.
financial statements that are filed by the Registered Fund with the NFA, the CFC will not be required to file separate financial statements.24

Financial Reporting Harmonization

Under the Harmonization Proposal, Registered Fund CPOs would have been required to comply with the monthly account statement requirement under Regulation 4.22(a), but would have been exempted from the distribution requirement under Regulation 4.22(b) as long as they made such statements available on their websites. In the Harmonization Adopting Release, the CFTC amended Regulation 4.12(c) to expand the scope of the proposed relief by entirely exempting Registered Fund CPOs from the monthly account statement distribution requirements under Regulations 4.22(a) and (b). Although amended Regulation 4.12(c) only refers to an exemption from the distribution requirements, we have confirmed with the CFTC staff that Registered Fund CPOs also are exempt from the requirement to prepare these monthly account statements. This relief is conditioned on a Registered Fund CPO’s making the Registered Fund’s current net asset value per share available to investors on a website or otherwise making the information available to participants (e.g., upon request). A CPO to an existing Registered Fund that wishes to rely on amended Regulation 4.12(c) also must disclose to participants the means through which the information will be made available by October 21, 2013.

The Harmonization Adopting Release does not extend relief to Registered Fund CPOs from the annual report requirements under Regulations 4.22(c)-(h).25 However, the CFTC staff has confirmed to us that a Registered Fund CPO is exempt from these requirements and will only be required to file with the NFA, and distribute to fund investors, the annual report the Registered Fund is required to prepare and file pursuant to the SEC’s rules.26 We understand that the Investment Company Institute (“ICI”) is in the process of requesting clarification that only the annual financial statements must be filed with the NFA, and not the entire annual report or Form N-CSR.

Recordkeeping Harmonization

Historically, the CFTC has mandated that CPOs and CTAs keep required records at their main business office.27 The books and records that a CPO must maintain for a pool include a detailed and itemized daily record of each commodity interest transaction, as well as copies of each confirmation of such transactions, all receipts and disbursements, a participant ledger, and other relevant records. A CTA must maintain similar transaction records for its managed accounts, a client list, and other relevant records.

In the Harmonization Adopting Release, the CFTC provided relief for CPOs by permitting them to maintain books and records with certain third parties, rather than at the main business office, subject to certain conditions. Permissible recordkeepers include the pool’s administrator, distributor or custodian, or a bank or registered broker or dealer acting in a similar capacity with respect to the pool. All CPOs may take advantage of this relief, not just Registered Fund CPOs. To claim this relief, the

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24 Harmonization Adopting Release, at 52319. See also No-Action Letter 13-51 (Sept. 5, 2013), which requires a filing to be made with the CFTC’s Division of Swap Dealer and Intermediary Oversight.
25 These provisions generally require a CPO to prepare and distribute to participants in each commodity pool that it operates an annual report, which includes, among other things, audited financial statements for the pool, and to file a copy of the report with the NFA, within 90 calendar days after the end of the pool’s fiscal year or the permanent cessation of trading, whichever is earlier.
26 The Harmonization Adopting Release indicates that the financial statements of a Registered Fund must be prepared pursuant to its obligations under applicable SEC requirements. See Harmonization Adopting Release, at 52311, but this is not made clear in the text of Regulation 4.12(c) itself.
27 CFTC Regulations 4.23 and 4.33. A CPO or CTA operating in accordance with CFTC Regulation 4.7 and dealing with investors or clients that meet the criteria of “Qualified Eligible Persons” are exempted from the specific recordkeeping requirements of CFTC Regulations 4.23 and 4.33, respectively. However, such CPOs and CTAs must maintain all books and records prepared in connection with their CPO or CTA activities (including, without limitation, records relating to the qualifications of qualified eligible persons and substantiating any performance representations); those CPOs must also maintain records of annual and periodic reports.
CPO, when registering or delegating its recordkeeping obligations, whichever is later, must file a prescribed statement with the NFA. The ICI is seeking clarification from the CFTC that Registered Fund CPOs that are already registered must file the notice by November 22, 2013 if they wish to take advantage of this relief or prior to delegating their recordkeeping obligations if they wish to do so subsequent to that date. Other registered CPOs must have filed by September 23, 2013 with respect to the existing commodity pools.

In addition to providing relief regarding the location of books and records for all CPOs, the Harmonization Adopting Release provides Registered Fund CPOs relief from the obligation to make records available for inspection and copying by any participant. This relief is intended to avoid having compliance with CFTC rules cause a Registered Fund CPO to violate SEC prohibitions on “selective disclosure.” The CFTC also noted that many Registered Funds hold account shares in an omnibus account, with records of participant information being kept by a transfer agent or financial intermediary, such as a broker-dealer or bank. The CFTC, therefore, will permit all CPOs to satisfy the subsidiary ledger requirement of Regulation 4.23(a)(4) through a transfer agent’s maintenance of records or through a list of relevant intermediaries where shares are held in omnibus accounts or through intermediaries.

In the Harmonization Adopting Release, the CFTC did not amend its recordkeeping regulations as extensively as commenters had requested. The CFTC is not permitting professional records maintenance and storage companies, subadvisers or CTAs to act as alternative recordkeepers, although we understand that the CFTC may expand the list of permitted recordkeepers. The CFTC also did not provide any recordkeeping relief, either with respect to where records may be maintained or the records required to be maintained, for CTAs, and it is less certain whether the CFTC staff will reconsider this position. Accordingly, a firm that is dually-registered as a CPO and a CTA must continue to maintain CTA-related records at its main business office rather than an alternative recordkeeper, thereby limiting the usefulness of the relief.

The CFTC did not also amend the list of required records a Registered Fund CPO must maintain under CFTC Regulation 4.23. However, the CFTC staff seems amenable to clarifying that Registered Fund CPOs do not need to maintain records relating to compliance obligations with which they are no longer required to comply, for example, Regulations 4.23(a)(10), (11) and (12) (monthly statements of financial condition and statements of income and signed account statements and annual reports, including balance records), and 4.23(b)(2)(i) and (ii) (confirmations relating to proprietary trading by the CPO itself and principals). We are hoping that the CFTC staff will confirm this in writing soon.

In addition, the CFTC did not amend Regulation 1.31, which requires CPOs and CTAs to maintain required books and records for five years and for those records to be readily accessible during the first two years of the five-year period. The books and records still must be open to inspection by any representative of the CFTC, the NFA or the DOJ. If a CPO or CTA wishes to maintain some or all of its required records solely in electronic format, before doing so, it must enter into an arrangement with

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28 The statement must include representations by the CPO that it will (1) promptly update the information regarding where books and records are kept as necessary; (2) maintain books and records in accordance with CFTC Regulation 1.31 (discussed further below); (3) provide the books and records at its main business office within 48 hours (72 hours if kept outside the United States) of a request by a CFTC representative; and (4) disclose in the pool’s Disclosure Document the location of its books and records. The CPO also must file electronically with NFA a statement from the alternative recordkeeper wherein such person: (i) acknowledges that the CPO intends that the person keep and maintain required pool books and records; (ii) agrees to keep and maintain such records in accordance with CFTC Regulation 1.31; and (iii) agrees to keep such required books and records open to inspection by any representative of the CFTC or the United States Department of Justice (“DOJ”) in accordance with CFTC Regulation 1.31 and to make such required books and records available to pool participants in accordance with CFTC Regulation 4.23. The CFTC staff indicated to us that a Registered Fund CPO may satisfy this disclosure requirement by including the location of the books and records in the registration statements for a Registered Fund in response to Item 33 of Form N-1A and Item 32 of Form N-2, as applicable.

29 See SEC Regulation FD (17 CFR 243.100-103) (with respect to closed-end RICs); Items 9(d) and 16(f) of SEC Form N-1A (open-end RICs required to disclose policies and procedures with respect to disclosure of portfolio securities and ongoing arrangements to make available information about portfolio securities).
at least one third party Technical Consultant. The Technical Consultant’s role is to provide the CFTC, the NFA and the DOJ with access to records in a readable format if the CPO or CTA were unable or unwilling to do so.\textsuperscript{30}

\textbf{Compliance Dates}

\textbf{A. Registered Fund CPO Provisions}

The Harmonization Rules for Registered Fund CPOs under Regulation 4.12, except 4.12(c)(3)(i) (the disclosure provisions), became effective upon publication of the Harmonization Adopting Release in the Federal Register, which took place on August 22, 2013. Accordingly, CPOs of existing Registered Funds seeking to rely on the exemption in Regulation 4.12(c)(3) were required to file the required notice by October 21, 2013, 60 days following publication.\textsuperscript{31} Regulation 4.12(c)(3)(i) became effective on September 23, 2013, and we understand that the ICI is seeking clarification from the CFTC staff that Registered Fund CPOs will be required to comply with the conditions in Regulation 4.12(c)(3)(i) (primarily presentation of past performance information for Registered Funds with less than a three year operating history) with respect to filings made on or after November 22, 2013, 60 days following the effective date of this provision, as follows:

- \textit{Open-End Registered Funds} – Upon filing an initial registration statement or upon filing a post-effective amendment that is an annual update to an existing registration statement.
- \textit{Closed-End Registered Funds} – Upon filing an initial registration statement or when the closed-end Registered Fund is required to update its registration statement.

\textbf{B. General CPO Provisions}

The amendments to Regulations 4.7(b)(4) (recordkeeping relief), 4.23 (recordkeeping), 4.26 (12-month use of Disclosure Document by CPOs) and 4.36 (12-month use of Disclosure Document by CTAs) became effective on September 23, 2013. CPOs are permitted to rely on the amendments on that date. Rescission of the signed acknowledgement requirement of Regulation 4.21(b) became effective upon publication of the Harmonization Adopting Release. Importantly, with respect to the amended recordkeeping provisions, we understand that the ICI is seeking clarification from the CFTC staff that (1) Registered Fund CPOs do not have to comply with the recordkeeping requirements of Regulation 4.23 until November 22, 2013, and (2) Registered Fund CPOs will not be in violation of the notice requirements with respect to books and records under Regulations 4.12(d)(2), 4.7(b)(5) and 4.23(c)(1), provided that they file such notice on or before November 22, 2013.

\textbf{Form CPO-PQR}

The Harmonization Adopting Release makes clear that Registered Fund CPOs must begin to comply with the requirement to file Form CPO-PQR 60 days following the effective date of the

\textsuperscript{30} The third party Technical Consultant cannot be someone in-house or certain affiliates, and must have the technical and financial capability to perform the undertakings set forth in CFTC Regulation 1.31(b)(4). If a CPO or CTA wishes to use an electronic storage system, it (or the storage system vendor or another third party with appropriate expertise) must provide a representation to the CFTC, prior to initial use, that the storage system meets the requirements of CFTC Regulation 1.31(b)(1)(ii). Those requirements are that the system: (A) preserves the records exclusively in a non-rewritable, non-erasable format; (B) verifies automatically the quality and accuracy of the storage media recording process; (C) serializes the original and, if applicable, duplicate units of storage media and creates a time-date record for the required period of retention for the information placed on such electronic storage media; and (D) permits the immediate downloading of indexes and records preserved on the electronic storage media onto paper, microfilm, microfiche or other acceptable medium upon the request of representatives of the CFTC or the DOJ. If a CPO or CTA were to employ an electronic storage system using media other than optical disk or CD-ROM technology, the representation must so state. The representation must be accompanied by an oath or affirmation that, to the best knowledge and belief of the individual making such oath or affirmation, the information contained in the representation is true and correct.

\textsuperscript{31} We have confirmed this interpretation with the CFTC staff, since the language in the Harmonization Adopting Release is not completely clear.
Harmonization Rules, which was October 21, 2013.\textsuperscript{32} Per our conversation with the CFTC staff, this means that existing Registered Fund CPOs will be required to file their first Form CPO-PQR with respect to the reporting period ending December 31, 2013. For Registered Fund CPOs that will not be required to file Form CPO-PQR quarterly, their first quarterly Form NFA-PQR filing will be for the first quarter of 2014.\textsuperscript{33}

Open Issues

Although the CFTC addressed a number of issues and concerns of Registered Fund CPOs and others with respect to its Part 4 regulations, a number of issues remain. They are briefly summarized below.

A. Open Issues for Registered Fund CPOs

1. **Section 17(d) Issues.** CFTC Regulation 4.20(c) provides that a CPO cannot “commingle the property of a pool it operates or that it intends to operate with the property of any other person.” NFA Compliance Rule 2-45 states that no member CPO “may permit a commodity pool to use any means to make a direct or indirect loan or advance of pool assets to the CPO or any other affiliated entity.” However, pursuant to orders and no-action letters under Section 17(d) of the Investment Company Act, the SEC and the SEC staff have long permitted Registered Funds to commingle their property with other persons under certain conditions and in certain circumstances, such as in connection with cash sweep vehicles and with respect to collateral posted in securities lending transactions. They have also permitted inter-fund loans under certain conditions.\textsuperscript{34} There is a conflict between these accommodations and the requirements of the CFTC rule.

The ICI raised these issues with the staff of the CFTC and the NFA in December 2012;\textsuperscript{35} however, the CFTC determined to reserve on the issue until the ICI provides the CFTC staff with more information about the type of relief the SEC has provided, and the conditions to which such relief is subject. The NFA did, however, on March 4, 2013, propose to amend its Compliance Rule 2-45 to permit Registered Funds to continue to engage in these transactions, subject to certain conditions, including the filing of a notice with NFA.\textsuperscript{36} This change was effective on September 13, 2013.

2. **CTAs to Registered Funds.** The relief in amended Regulation 4.12(c) is only available to Registered Fund CPOs. If a Registered Fund has a sub-adviser, that sub-adviser can no longer rely on the exemption in CFTC Regulation 4.14(a)(8), which is predicated on the Registered Fund CPO being excluded from being a CPO under CFTC Regulation 4.5. Therefore, a sub-adviser will presumably be registered as a CTA in order to provide commodity interest trading advice to the Registered Fund.

\textsuperscript{32} Registered Fund CPOs that could not comply with amended CFTC Regulation 4.5 were not required to file Form CPO-PQR on registration as such. The effectiveness of that requirement was deferred in the Regulation 4.5 Adopting Release until 60 days following the adoption of the CFTC’s final harmonization rule. See Regulation 4.5 Adopting Release, at 11252.

\textsuperscript{33} Form NFA-PQR consists of Schedule A of Form CPO-PQR plus the Schedule of Investments. See NFA Compliance Rule 2-46.


\textsuperscript{35} See Letter dated December 21, 2012 from Karrie McMillan, General Counsel of the ICI, to Gary Barnett, Director of the CFTC’s Division of Swap Dealer and Intermediary Oversight, and the letter dated December 21, 2012 from Karrie McMillan, General Counsel of the ICI, to Daniel A. Driscoll, Executive Vice President and Chief Operating Officer, and Thomas W. Sexton, III, Senior Vice President, General Counsel and Secretary, of the NFA.

\textsuperscript{36} See Letter dated March 4, 2013 from Thomas W. Sexton, III Senior Vice President and General Counsel of NFA, to Mr. Christopher Kirkpatrick, Deputy Secretary, CFTC.
The Harmonization Adopting Release does not address the sub-adviser’s obligations under the Part 4 regulations with respect to the Registered Fund. The CFTC Division of Swap Dealer and Intermediary Oversight’s (“DSIO”) frequently asked questions, in the answer to question 3 under the heading “Compliance Dates,” indicated that sub-advisers to Registered Funds that can no longer rely on CFTC Regulation 4.14(a)(8) would have until 60 days following the effective date of the Harmonization Rules to come into compliance with the CFTC’s Part 4 regulations. Thus, the question remains whether such a sub-adviser will be required to prepare a fully compliant CTA Disclosure Document, pre-clear it with the NFA staff, deliver it to the Registered Fund CPO and update it every 12 months, or whether compliance with the SEC’s rules under the Investment Company Act would be sufficient. Importantly, if relief is not available to such CTAs, they would, among other things, be required in some cases to provide copious amounts of performance information. The CFTC staff has indicated some willingness to reconsider whether a CTA Disclosure Document is required in all cases, and the ICI has requested clarification of this requirement with respect to existing subadvisory arrangements.

3. Conforming NFA’s Rules. In a letter dated December 28, 2012 from the ICI to the NFA staff, the ICI confirmed that the NFA would not require Registered Fund CPOs and CTAs to comply with certain NFA rules until after the Harmonization Adopting Release is effective. Those rules included Compliance Rule 2-10 (books and records), Compliance Rule 2-13 (break-even analysis), Compliance Rule 2-29 (promotional materials), Compliance Rule 2-34 (CTA performance reporting and disclosure), Compliance Rule 2-35 (contents and delivery of CPO and CTA disclosure documents) and Compliance Rule 2-46 (filing of NFA-PQR and NFA-PR). In addition, NFA staff confirmed to the ICI that, pending further NFA review of how the SEC and the Financial Industry Regulatory Authority (“FINRA”) rules address the review, approval and supervision of promotional material, the NFA will deem compliance by a Registered Fund’s “principal underwriter or by another broker-dealer with FINRA’s review, approval, filing, recordkeeping and supervision requirements with respect to fund promotional materials . . . to satisfy a fund CPO’s or CTA’s obligation to comply with NFA Compliance Rules 2-9, 2-29 and related interpretive notices, as applicable.”

The NFA staff have advised us that they plan to amend their rules to conform them to the CFTC’s rules adopted in the Harmonization Adopting Release; however, in the meantime, the NFA’s staff would not anticipate taking action against a Registered Fund CPO or CTA under the NFA’s rules if the Registered Fund CPO or CTA were in compliance with the CFTC’s amended Part 4 regulations. The NFA is continuing to study the SEC’s and FINRA’s advertising rules.

B. Open Issues for Others

1. JOBS Act. The CFTC noted that the Managed Funds Association (“MFA”) had requested that the CFTC amend CFTC Regulations 4.7(b) and 4.13(a)(3) to permit general solicitation in the manner permitted by amended Rule 506 under the Securities Act. The exemption in Regulation 4.7(b) is only available with respect to pools “that are offered or sold, without marketing to the public” and the exemption in Regulation 4.13(a)(3) is available only with respect to pools “that are offered and sold without marketing to the public in the United States.” Therefore, it is possible that a CPO that is relying on either of these exemptions would lose the exemptions if the fund engaged in general solicitation when SEC Rule 506(c) became effective on September 23, 2013. The CFTC declined to amend these rules in the Harmonization Adopting Release because these requested rule

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38 See Letter dated December 28, 2012 from Karrie McMillan, General Counsel of the ICI, to Daniel A. Driscoll, Executive Vice President and Chief Operating Officer, and Thomas W. Sexton, III, Senior Vice President, General Counsel and Secretary, of the NFA.
39 See Letter dated July 17, 2012 from Stuart J. Kaswell, Executive Vice President, Managing Director and General Counsel of the MFA, to David A. Stawick, Secretary of the CFTC.
changes were not subject to notice and comment. We understand that the DSIO staff is studying this issue.

2. Timing of Annual and Quarterly Reports under Regulations 4.7 and 4.22. Both the Investment Adviser Association (“IAA”) and the MFA had requested that the CFTC harmonize the annual report deadlines in Regulations 4.7(b) and 4.22 with the deadline in the SEC’s Custody Rule (Advisers Act Rule 206(4)-2). The Custody Rule gives advisers to private funds up to 120 days to furnish audited annual financial statements to investors; in contrast, the CFTC’s rules require these financials to be furnished within 90 days of fiscal year end. The MFA also asked that CPOs relying on the exemption in Regulation 4.7(b) be permitted to furnish their quarterly reports to investors within 45 days after the end of the quarter, instead of 30 days. Neither of these issues was addressed in the Harmonization Adopting Release.

3. Unrelated Performance for Non-Regulation 4.7 Pools. The IAA requested that the CFTC harmonize mandatory performance reporting requirements for all CPOs and CTAs, not just Registered Fund CPOs, to the extent that the CFTC’s rules would require them to present performance in a manner that would conflict with the SEC’s rules. This issue was not addressed in the Harmonization Adopting Release.

4. Delivery of Disclosure Documents and Account Statements Via Websites. The IAA requested that all CPOs be permitted to deliver their disclosure documents and account statements via websites. This issue was not addressed in the Harmonization Adopting Release.

Conclusion

The Harmonization Adopting Release defers in large measure to the SEC’s requirements for Registered Funds and addresses most, but not all, of the issues raised by the ICI and the other commenters. Further, we are hopeful that the CFTC staff will clarify in writing their interpretation of some of the open issues in the Harmonization Adopting Release, as noted above, so that the industry will have further authoritative guidance on which to rely.

But, as also noted above, there are a number of remaining questions and issues. It may take several more months before most of the remaining issues are resolved.

Authors:

Cary J. Meer  
cary.meer@klgates.com  
+1.202.778.9107

Mark C. Amorosi  
mark.amorosi@klgates.com  
+1.202.778.9351

Lawrence B. Patent  
lawrence.patent@klgates.com  
+1.202.778.9219

Susan I. Gault-Brown  
susan.gaultbrown@klgates.com  
+1.202.778.9083

Leeron Avnery  
leeron.avnery@klgates.com  
+1.202.778.9441

Mary K. Clarke-Pearson  
mary.clarke-pearson@klgates.com  
+1.202.778.9458

Craig A. Ruckman  
craig.ruckman@klgates.com  
+1.202.778.9174

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40 Harmonization Adopting Release at 52322.
41 See Letter dated April 24, 2012 from Karen L. Barr, General Counsel of the IAA, to David Stawick, Secretary of the CFTC (“IAA Letter”), and letter dated April 24, 2012 from Stuart J. Kaswell, Executive Vice President, Managing Director and General Counsel of the MFA, to David A. Stawick, Secretary of the CFTC (“MFA Letter”).
42 See MFA Letter.
43 See IAA Letter.
44 Id.