US Derivatives Regulation: Expanded "Commodity Pool" Definition and CPO/CTA Rules

by Practical Law Finance

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A Practice Note detailing the implications of the expansion of the definition of "commodity pool" under the Commodity Exchange Act, as mandated under Title VII of the Dodd-Frank Act, to include entities such as funds and securitization vehicles that use derivatives to provide investment exposure. The Note also details Dodd-Frank rules for both CPOs and CTAs.

Title VII of the **Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010** (Dodd-Frank Act) expanded the definition of "commodity pool" under Section 1a(10)(A) of the **Commodity Exchange Act** (CEA) (7 U.S.C. § 1a(10)(A)) and under Regulation 4.10(d) of the **Commodity Futures Trading Commission** (CFTC) (17 C.F.R. § 4.10(d)) to include entities such as funds and securitization vehicles that use swaps to provide investment exposure. These vehicles now fall within this definition, subjecting their operators and managers to registration and a framework of regulation as commodity pool operators (CPOs).

A CPO is an individual or organization that operates and solicits funds for a commodity pool. A commodity pool is composed of funds contributed by a number of entities and/or individuals, which are combined for the purpose of:

- Trading **futures contracts**, options on futures, or retail off-exchange foreign exchange (FX) contracts (retail forex).
- Investing in another commodity pool.

A commodity trading advisor (CTA) is an individual or organization that advises others on the buying or selling of futures contracts, options on futures, or off-exchange retail forex contracts.

All registered CPOs must be members of the National Futures Association (NFA) in order to conduct futures business with the public. All registered CTAs that manage or exercise discretion over customer accounts must be members of the NFA in order to conduct futures business with the public. CPOs and CTAs must register with the CFTC through the NFA.

This Note discusses the expanded definition of "commodity pool" under the CEA, as amended by Title VII of the Dodd-Frank Act, and the expanded CPO registration requirements resulting from this amendment, as well as certain rules introduced by the Dodd-Frank Act for CPOs and CTAs.

Expanded "Commodity Pool" Definition: Swaps Now Included

The Dodd-Frank Act expanded the definition of "commodity pool" under Section 1a(10)(A)of the CEA (7 U.S.C. § 1a(10)(A)) and under CFTC Regulation 4.10(d) (17 C.F.R. § 4.10(d)), effective July 16, 2011, to include entities that operate pooled investment vehicles and manage commodity trading accounts that enter into swaps. This definition now encompasses pools that enter into a broad range of swaps, not just commodity swaps (as was the case prior to these changes).

As a result of these changes, many funds and investment managers that enter into swaps are required to register as CPOs. Many funds, fund managers, and investment managers also have Dodd-Frank swap-related obligations, regardless of whether or not their swap activities are for client accounts or for their own investment or risk-mitigation activities (see this Note generally and Legal Update, Certain Dodd-Frank Swap Rules to Apply

to CPOs and CTAs). Also, as a result of the expanded "commodity pool" definition, certain securitization vehicles and ABS issuers that enter into swaps are now required to register as CPOs (see CPO Registration for ABS Issuers).

FX Exclusion

In October 2012, the CFTC issued No-Action **Letter** 12-21, permitting parties to exclude their FX swaps and FX forwards when determining if they must register as a CPO or CTA, provided the Secretary of the Treasury issued a final **exemption** for those transactions from the definition of "swap" under the CEA that was effective by December 31, 2012 (see Legal Update, No-Action Guidance on SD, MSP, and CPO Rules Under Dodd-Frank Issued by CFTC). Treasury issued the final determination effective November 20, 2012 (77 Fed. Reg. 69694 (November 20, 2012)).

Section 4.27 Reporting

On February 9, 2012, the CFTC issued final rules under the Dodd-Frank Act (77 Fed. Reg. 11252 (February 24, 2012)) that rescinded certain registration and compliance **exemptions** for CPOs and CTAs (see also the CFTC's fact sheet and Q&A). These final rules also:

- Adopted new data collection rules for CPOs and CTAs that are consistent with the data collection requirements under the Dodd-Frank Act for entities registered with both the CFTC and the **Securities and Exchange Commission** (SEC) (17 C.F.R. § 4.27(b).
- Include new risk-disclosure requirements for CPO and CTA swap transactions (17 C.F.R. §§ 4.24(b) and 4.34(b).

These final rules are effective and compliance is required. For more information, see Section 4.27 Reporting for CPOs and CTAs.

The CFTC also amended CFTC regulations 4.7, 4.22, 4.23, 4.24, 4.30, 4.32, 4.33 and 4.34 (17 C.F.R. §§ 4.7, 4.22, 4.23, 4.24, 4.30, 4.32, 4.33, and 4.34) to include specific reference to swaps and swap-trading activities. Prior to these amendments, these regulations required CPOs and CTAs to undertake certain recordkeeping, reporting, and operational activities for so-called "commodity interest" transactions only (transactions involving futures contracts, commodity options, and off-exchange retail foreign currency) (77 Fed. Reg. 54355 (September 5, 2012)). The amendments extend these recordkeeping, reporting, and operation activity requirements to the swap transactions of these entities as well. For more information, see Dodd-Frank Collection and Disclosure Rules for CPOs and CTAs.

Revised Ratio Reporting Requirements

On December 19, 2016, the NFA published Notice I-16-31 notifying registered CPOs and CTAs that "new ratio" reporting requirements would apply to reports submitted under CFTC Regulation 4.27 as of the end of the second quarter 2017 (ending June 30, 2017). These new ratio reporting requirements require reporting of the following financial information on NFA forms PQR and PR to assist the NFA in evaluating trends relating to a registrant's financial condition:

- Current assets/current liabilities. This new ratio takes the current asset balance at the reporting quarter-end and divides it by current liability balance at the reporting quarter-end to measure liquidity.
- Total revenue/total expenses. This new ratio divides total revenue incurred during the prior 12 months by total expenses from the same time period to measure operating margin. Implementation of this requirement will be phased-in.

The NFA specifies that the ratios must be computed using the accrual method of accounting and in accordance with **generally accepted accounting principles** (GAAP) or another internationally recognized accounting standard, consistently applied. A CPO or CTA that is part of a holding company/subsidiary structure may elect to report the ratios at the parent level. Any registrant that is dually-registered as a CPO and CTA will only be required to report the new ratios once per quarter.

The NFA has provided the following resources to assist CPOs and CTAs to understand the reporting requirements and the calculation of the ratios:

- The NFA website provides workshop material to assist registrants in reporting financial ratios. An audio recording of the workshop is also available.
- Forms PQR and PR will include help text providing additional guidance regarding how to complete the new data fields.
- NFA **staff** will work with members during examinations to ensure that the firm is calculating the ratios correctly.

Registration Exemptions

The final rules amend sections of Part 4 of the CFTC's regulations regarding registration **exemptions** for CPOs and CTAs (77 Fed. Reg. 11252 (February 24, 2012)).

Sections 4.5 and 4.13 for CPOs

All entities and individuals claiming exemptive or exclusionary relief from registration as a CPO under CFTC Regulations 4.5 and 4.13 must do one of the following:

- Confirm their notice of claim of **exemption** or exclusion from registration as a CPO with the NFA on an annual basis at calendar year end.
- Withdraw the exclusion or **exemption** and apply for CPO registration within 60 days of the anniversary of its initial filing under one of these sections.
- Cease operating as a CPO and withdraw the exclusion or **exemption** due to a cessation in the underlying activities.

(17 C.F.R. §§ 4.5 and 4.13.)

Section 4.5
Registered **investment companies** (RICs) registered with the SEC under the **Investment Company Act of 1940** (ICA) can no longer rely on an exclusion from registration as CPOs under Section 4.5 (17 C.F.R. § 4.5). The **investment advisor** of a CPO, not its board of directors, is required to register as the CPO under the final rules. Registration for CPOs that had relied on the Section 4.5 **exemption** and for which there was no other available **exemption** from registration was required by December 31, 2012 (see Legal Updates, Final Rules Amending CPO, CTA Registration, and Compliance Obligations Issued by CFTC).

For further details, see CPO RIC Rules: **Exemption** from Dual Obligations but Not Dual Registration.

In June 2013, the US Court of Appeals for the District of Columbia in *Inv. Co. Inst. v. Commodity Futures Trading Comm'n,* 720 F.3d 370 (D.C. Cir. 2013) affirmed a decision of the US District Court for the District of Columbia upholding the more stringent requirements of amended CFTC Regulation 4.5, which rescinded CPO registration exclusions for certain RICs that participate in the futures and swaps markets and CFTC Regulation 4.27 which requires registered CPOs to report certain information to the CFTC and other federal regulators on new Form CPO-PQR (see Section 4.27 Reporting for CPOs and CTAs). As a result of this decision, RICs are now required to register as CPOs (see Legal Update, CFTC Dodd-Frank CPO Fund Registration Rule Upheld by DC District Court).

Section 4.13(a)(4)
This amendment rescinded the "sophisticated investor" **exemption** from CPO registration provided in CFTC regulation 4.13(a)(4) (17 C.F.R. § 4.13(a)(4)). Existing CPOs that previously relied on Rule 4.13(a)(4) for **exemption** from CPO registration which invest on behalf of certain private funds were required to register with the CFTC as CPOs and become members of the NFA or rely on a different **exemption** from registration, by December 31, 2012.

Section 4.13(a)(3)
Exclusions from CPO registration are still available under CFTC regulation 4.13(a)(3) (17 C.F.R. § 4.13(a)(3)) for entities that engage in what is deemed a **de minimis** amount of derivatives trading activity. A net **notional value** test is included so that the **exemption** is available to certain RICs whose:

- Aggregate **initial margin** and premiums required to establish positions in futures, option contracts, and swaps does not exceed 5% of the liquidation value of the entity's portfolio (after taking into account unrealized profits and losses); or
- Aggregate net notional value of futures, option contracts, and swaps (determined at the time the most recent position was established) does not exceed 100% of the liquidation value of the fund's portfolio (after taking into account unrealized profits and losses).

The CFTC also amended regulation 4.13(a)(3) to permit calculations for these tests to allow unlimited use of futures, options, or swaps for bona fide hedging purposes (see Bona Fide Hedging Definition), which had not been permitted under 4.13(a)(3). The net notional test as it appears in section 4.13(a)(3) was also amended to provide guidance regarding the ability to **net** cleared swaps. (4.13(a)(3)(ii)(B) (17 C.F.R. § 4.13(a)(3)(ii)(B))).

For example, the notional value of an entity's futures contracts, for purposes of the test, is derived by multiplying the number of contracts by the size of the contract, in contract units, and then multiplying by the current market price for the contract. The notional value of a cleared swap, however, is determined consistently with the provisions of Part 45 of the CFTC's regulations (the final SDR rules) (see Practice Note, US Derivatives Regulation: CFTC Swap Data Reporting and Recordkeeping Rules: Part 45 (SDR) Data Reporting Rules). The ability to net positions is also determined by asset

class, and with netting of futures contracts across **designated contract markets** (DCMs) or foreign boards of trade (FBOTs) is permitted, whereas swaps may only be netted if cleared by the same **designated clearing organization** (DCO) and is otherwise appropriate.

Section 4.13(b)(1)
Any person or entity claiming the relief from registration provided by 4.13(a) must file electronically a notice of **exemption** from CPO registration with the NFA through its electronic **exemption** filing system. The notice must:

- Provide the name, main business address, main business telephone number, main facsimile number, and main email address of the person claiming the **exemption** and the name of the pool for which it is claiming the **exemption**.
- Include the section number to which the operator is filing the notice (e.g., section 4.13(a)(1), (2) or (3)) and represent that the pool will be operated in accordance with the criteria of that paragraph.
- Be filed by a representative duly authorized to bind the person.

(17 C.F.R. § 4.13(b)(1).)

Sections 4.6 and 4.14 for CTAs

All entities and individuals claiming exemptive or exclusionary relief from registration as a CTA under CFTC Regulations 4.6 and 4.14 must do one of the following:

- Confirm their notice of claim of **exemption** or exclusion from registration as a CPO with the NFA on an annual basis at calendar year end.
- Withdraw the exclusion or **exemption** and apply for CPO registration within 60 days of the anniversary of its initial filing under one of these sections.
- Cease operating as a CPO and withdraw the exclusion or **exemption** due to a cessation in the underlying activities.

(17 C.F.R. §§ 4.6 and 4.14.)

Section 4.7 for CPOs and CTAs

To promote consistency between regulation 4.7 (17 C.F.R. § 4.7) and the SEC's definition of **accredited investor** under **Regulation D** of the Securities Act of 1933, the CFTC modified Regulation 4.7 to incorporate the SEC's accredited investor standard by reference, rather than by direct inclusion of its terms, as was previously the case. This permits the CFTC's definition of "qualified eligible person" to continue to include the specific terms of the SEC's accredited investor standard in the event that it is later modified by the SEC, without requiring the CFTC to further amend Section 4.7.

The accredited investor **exemption** in Regulation 4.7 remains available but is an **exemption** from certain CPO and CTA disclosure and compliance obligations required by the CFTC, not an **exemption** from CPO and CTA registration or from annual CPO and CTA reporting obligations. Revised Section 4.7 also no longer allows CPOs or CTAs to claim **exemption** from the requirement that an exempt CPO's or CTA's annual report contains certified financial statements.

CFTC-registered **swap dealers** (SDs) are included among the persons listed in CFTC regulation 4.7(a)(2) (17 C.F.R. § 4.7(a)(2)) that do not have to satisfy a portfolio requirement to be a qualified eligible person. As a result, a CPO or CTA claiming relief under CFTC regulation 4.7 may accept the SD as a pool participant or advisory client without regard to the size of its investment portfolio.

Section 4.27 Reporting for CPOs and CTAs: Forms CPO-PQR and CTA-PR

The final Dodd-Frank CPO/CTA rules require CPOs and CTAs to file reports under Section 4.27 (17 C.F.R. § 4.27), that provide additional information regarding their activities so that the CFTC can monitor the risks posed by these participants in the commodity futures and derivatives markets. These reports, filed on Forms CPO-PQR for CPOs and CTA-PR for CTAs, must include a description for each pool under that CPO's or CTA's management of, among other things:

- Assets under management (AUM).
- The use of leverage.
- Counterparty credit risk exposure.

- Trading and investment positions.

These Section 4.27 reporting requirements took effect on July 2, 2012. The compliance dates for reporting under Section 4.27 began:

- For CPOs with at least $5 billion in assets under management: 60 days after the end of the CPO's first calendar quarter that ended after July 2, 2012.
- For all other large CPOs, defined as having assets of at least $1.5 billion: 60 days after the end of the CPO's first calendar quarter that ended after December 14, 2012.
- All other CPOs and CTAs: 90 days after calendar year end 2012.

The CFTC also amended its standardized risk disclosure statements for CPOs and CTAs to require disclosure of certain risks associated with the use of swaps. These new disclosure statements are required for all new CPO and CTA disclosure filings with the NFA and all updates filed after the effective dates of the final rules.

The newly added CFTC reporting requirements on Form CPO-PQR are a supplement to Form PF for advisors that are dually registered with the SEC and file Section 1 and 2 on Form PF. These dual registrants are now only required to submit Schedule A of Form CPO-PQR. CPOs registered only with the CFTC are still required to file all relevant sections of Form CPO-PQR. All CTAs, regardless of whether they are registered with the SEC, are required to file Form CTA-PR.

On November 5, 2015, The CFTC released FAQs clarifying that CPOs may qualify for an **exemption** from CFTC registration based on a low level of trading are also exempt from filing Form CPO-PQR as is generally required under CFTC reporting requirements for CPOs. This clarifies exemptive relief that the CFTC previously granted in Exemptive **Letter** 14-115 (see Legal Update, CFTC Addresses Key CPO Issues). For more information on these FAQs, see Legal Update, CFTC Exempts Small CPOs from Filing Form CPO-PQR.

For details on further no-action relief regarding CPOs and Form CPO-PQR, see Legal Update, CFTC Addresses Key CPO Issues.

Ongoing Reporting Deadlines

Ongoing CPO reporting deadlines include:

- Sixty days after the end of every fiscal quarter. This is the filing deadline for Form CPO-PQR for large CPOs (those with Gross AUM of $5 billion or more attributable to pools as of the last fiscal quarter-end).
- January 30. This is the annual re-certification deadline for CPOs under regulation 4.13(a)(3) (17 C.F.R. § 4.13(a)(3)).
- Ninety days after the end of every fiscal year. This is the filing deadline for Form CPO-PQR for Mid-Sized and Small CPOs (those with Gross AUM under $5 billion attributable to pools as of the last fiscal quarter-end).

Ongoing CTA reporting includes an annual report due within 45 days of the end of the fiscal year.

Dodd-Frank Data Collection and Disclosure Rules for CPOs and CTAs

On August 23, 2012, the CFTC approved final amendments to its regulations, requiring CPOs and CTAs to provide information on their swap activities under the disclosure, reporting, and recordkeeping rules of Part 4 of the CFTC's regulations (77 Fed. Reg. 54355 (September 5, 2012)).

Under the amended regulations, CPOs and CTAs must disclose to the CFTC or investors in the commodity pool, or both, as applicable:

- Any material business dealings between any of the pool, the CPO, the CTA, the applicable **futures commission merchant** (FCM), retail foreign exchange dealer (RFED), SD, or principals of any of these that were not previously disclosed (17 C.F.R. § 4.22(a)(3).
- The principal risk factors involved in participation in the offered pool or the trading program (17 C.F.R. §§ 4.24(g) and 4.34(g)).
- The approximate percentage of the pool's assets that are or will be used to trade commodity interests, securities, and other types of interests 17 C.F.R. § 4.24(h)(1)(i)).
- Costs and fees included in the spread between bid and ask prices for retail forex and swap transactions and how those fees are calculated. (17 C.F.R. §§ 4.24(i)(2)(xii) and 4.34(i)(2)).
- Fees determined by reference to a base amount (such as "net assets," "gross profits," "net profits," "net gains," or "bid-asked spread"), accompanied by an explanation of how the base amount is calculated (17 C.F.R. §§ 4.24(i)(3) and 4.34(i)(2).

- The identity of the pool's FCMs, RFEDs, swap dealers, and introducing brokers (17 C.F.R. § 4.24(l)(1)(iii) and 17 C.F.R. § 4.34(j)(1)(ii), (iii)) – but 4.34(j) for CTAs doesn't include swap dealers.
- The identity of any other person providing services to the pool, soliciting participants for the pool, acting as a counterparty to the pool's retail forex, or swap transactions (17 C.F.R. § 4.24(j)(1)(vi)).
- Any arrangement under which a person may benefit from:
  - the maintenance of the pool's account or of a client's commodity interest account with the FCM or RFED (17 C.F.R. § 4.24(j)(3));
  - the maintenance of the pool's swap position or a client's swap positions with an SD (17 C.F.R. § 4.24(j)(3));
  - the introduction of the pool's account to an FCM, RFED, or SD by an introducing broker (17 C.F.R. § 4.24(j)(3));
  - the introduction of an investment of pool assets in investee pools, funds, or other investments (17 C.F.R. § 4.24(j)(3));
  - the maintenance of a client's commodity interest account with an FCM or RFED (17 C.F.R. § 4.34(j)(3); or
  - the introduction of a client's commodity interest account through an introducing broker (17 C.F.R. § 4.34(j)(3).
- The identity of any introducing broker through which a CTA's client will be required to introduce its account to the FCM, RFED, or SD (17 C.F.R. § 4.34(k)(1)(iii).

CPOs and CTAs must retain copies of each transaction confirmation or acknowledgement for each commodity interest transaction, as well as each purchase and sale statement and monthly statement received from a FCM, RFED, or SD. CPOs and CTAs must also maintain itemized daily records of commodity interest transactions undertaken by the pool, the CPO, and the CTA. CPOs and CTAs that are counterparties to swap transactions are also subject to final swap data recordkeeping and reporting requirements under Part 45 to the CFTC's regulations (added under Title VII of the Dodd-Frank Act), referred to as final SDR rules (see Practice Note, US Derivatives Regulation: CFTC Swap Data Reporting and Recordkeeping Rules: Part 45 (SDR) Data Reporting Rules).

CPOs and CTAs must refrain from soliciting, accepting, or receiving from an existing or prospective client, funds, securities, or other property in the CPO's or CTA's name to purchase, margin, guarantee, or secure any commodity interest of the client. Exceptions to this rule for certain FCMs, CTAs, RFEDs, and SDs that are registered under the CEA are included in CFTC Regulation 4.30(b) (17 C.F.R. § 4.30(b)).

CPO RIC Rules: Exemption from Dual Obligations but Not Dual Registration

In August 2013, the CFTC issued final rules exempting from the CFTC's CPO compliance and reporting regime RICs that are now also required to register as CPOs under the changes to Section 4.5 of the CFTC's regulations (17 C.F.R. § 4.5), discussed above (see Section 4.5). RICs that are now required to register as CPOs under these modifications may substitute compliance with SEC rules for RICs instead of the CFTC's CPO regime, provided certain conditions are met (see Legal Update, CFTC: Registered Investment Company CPOs Exempted from Dual Obligations).

Note that CFTC reporting requirements on Form CPO-PQR added by the final rules (see Section 4.27 Reporting for CPOs and CTAs) are a supplement to Form PF for advisors that are dually registered with the SEC and file Section 1 and 2 on Form PF. These dual registrants are now only required to submit Schedule A of Form CPO-PQR. CPOs registered only with the CFTC are still required to file all relevant sections of Form CPO-PQR. All CTAs, regardless of whether they are registered with the SEC, are required to file Form CTA-PR.

Bona Fide Hedging Definition

The CFTC issued Interpretive Letter 12-19 on October 12, 2012, clarifying the definition of "bona fide hedging" for the purposes of CPO calculations by RICs in light of the 2012 district court ruling in *Int'l Swaps & Derivatives Ass'n v. U.S. Commodity Futures Trading Comm'n*, 887 F. Supp. 2d 259 (D.D.C. 2012). In this case, the district court vacated the CFTC's final position limits rules, which amended the definition. In the letter the CFTC states its position that this amended definition remains applicable (see Legal Update, No-Action Guidance on SD, MSP, and CPO Rules Under Dodd-Frank Issued by CFTC).

Exemptions from Certain CPO Reporting Rules for Certain Foreign Funds Registered as Investment Companies

On September 5, 2013, the CFTC issued No-Action Letter 13-51 granting relief to CPOs of funds registered under the ICA (registered funds) that trade in commodity interests through wholly owned controlled foreign corporations (CFCs) from CPO reporting requirements under CFTC regulations 4.22(c) and 4.27(c) (17 C.F.R. §§ 4.22(c), 4.27(c)). For more information, see Legal Update, CFTC Issues No-Action Relief from Certain CPO Reporting Obligations.

CPO Registration for ABS Issuers

As a result of the expanded CEA "commodity pool" definition under the Dodd-Frank Act (see Expanded "Commodity Pool" Definition: Swaps Now Included), certain securitization vehicles and ABS issuers that enter into swaps are now required to register as CPOs.

However, in CFTC Interpretive **Letter** 12-14 (**Letter** 12-14), the CFTC clarified that securitization vehicles meeting certain conditions would be excluded from the definition of "commodity pool" under the CEA (see Securitization Vehicles Excluded Under No-Action **Letter** 12-14). **Letter** 12-14 therefore excludes these vehicles from the CFTC's commodity pool regulations, including registration and reporting requirements, and operators of the vehicles are exempt from registration as CPOs.

Letter 12-14 specified a non-exclusive list of criteria for **exemption** from the "commodity pool" definition for securitization vehicles. No-Action **Letter** 12-45 (No-Action 12-45) further exempted certain securitization vehicles that do not strictly meet the criteria listed in **Letter** 12-14 (see Securitization Vehicles Excluded Under No-Action **Letter** 12-45), however the relief provided in No-Action 12-45 has expired.

Securitization Vehicles Excluded Under Interpretive Letter 12-14

Interpretive **Letter** 12-14 issued in October 2012, clarified that certain securitization vehicles would not be included within the expanded definition of "commodity pool" under Section 1a(10) of the CEA (7 U.S.C. § 1a(10)) and under CFTC Regulation 4.10(d) (17 C.F.R. § 4.10(d)) if they meet all of the following conditions:

- The issuer of the **asset-backed securities** (ABS) is operated consistently with the conditions specified in SEC **Regulation AB** or Rule 3a-7 under the ICA (17 C.F.R. § 270.3a-7), whether or not the issuer's securities offerings are in fact regulated under either regulation, such that the issuer, the pool assets, and the issued securities satisfy the requirements of either regulation.
- The issuer's activities are limited to passively owning or holding a pool of receivables or other financial assets, which may be either fixed or revolving, that by their terms convert to cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distributions of proceeds to security holders.
- The issuer's use of derivatives is limited to the uses permitted under the terms of Regulation AB, which include credit enhancements and the use of derivatives such as interest rate and currency swaps to alter the payment characteristics of the cash flows from the issuing entity.
- The issuer makes payments to security holders only from cash flows generated by its pool assets and other permitted rights and assets, and not from or otherwise based upon changes in the value of the entity's assets.
- 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.

Entities that satisfy these criteria receive only limited types of support from swaps and therefore qualify to use an alternative disclosure regime under Regulation AB or an **exemption** from regulation under the ICA. However, the issuer would not be entitled to claim the exclusion provided under **Letter** 12-14 if:

- its operating or trading activities are more active than contemplated by **Letter** 12-14;
- it does not limit its investments to financial assets that are used to pay the issuer's securities; or
- it uses swaps to create **synthetic investment** exposure.

Note that while **Letter** 12-14 itself does not explicitly mention No-Action **Letter** 12-15, it effectively extended the deferrals granted under No-action **Letter** 12-15.

Securitization Vehicles Excluded Under No-Action Letter 12-45

CFTC No-Action **Letter** 12-45 (No-action 12-45), issued in December 2012, further excluded from the "commodity pool" definition those securitization vehicles that do not satisfy the operation or trading limitations of Regulation AB or Rule 3a-7 of the ICA (17 C.F.R. § 270.3a-7) (the first criterion listed above from **Letter** 12-14) but:

- That continue to satisfy the second criterion above from the **Letter** 12-14 (second bullet) regarding the ownership of financial assets (see Securitization Vehicles Excluded Under No-Action **Letter** 12-14).
- Whose use of swaps is no greater than that contemplated by Regulation AB and Rule 3a-7.

- Whose swaps are not used in any way to create investment exposure.

No-action 12-45 specifies the following examples of securitization vehicles that qualify for the **exemption** from the "commodity pool" definition:

- Traditional asset-backed commercial paper (ABCP) conduits.
- Traditional **collateralized debt obligation** (CDO) asset pools.
- Covered bond pools that contain no commodity interests.
- Vehicles that, absent other factors, use swaps to provide credit support to financial assets in a securitization or to notes issued by the issuer in a securitization to the extent contemplated under Item 1114 of Regulation AB (17 C.F.R. § 229.1114), unless the use of swaps is commercially unreasonable as credit support with respect to that asset pool.

No-action 12-45 specifies, however, that the following are not excluded from the "commodity pool" definition because they include derivatives (typically **credit default swaps**) in the asset pool or otherwise use derivatives as pool investments:

- Synthetic securitizations such as synthetic CDOs (see Practice Note, Securitization: US Overview: Synthetic Securitizations (Synthetic CDOs)).
- Repackaging vehicles that issue credit-linked or equity-linked notes where the vehicle owns high-quality financial assets but **sells credit protection** on a broad based index through use of a swap.

Permanent Relief for "Legacy Vehicles"

No-action 12-45 also provides permanent relief from commodity pool regulations to operators of most securitization vehicles that issued securities before October 12, 2012 (sometimes referred to as "legacy vehicles"). The CFTC concluded that certain legacy vehicles might face significant operational difficulties if the commodity pool compliance regime under the commodity pool regulations were imposed upon them. To be eligible for this no-action relief, the following criteria must be satisfied and remain satisfied:

- The issuer issued fixed-income securities before October 12, 2012 that are backed by and structured to be paid from payments on or proceeds received from, and whose creditworthiness primarily depends on, cash or synthetic assets owned by the issuer.
- The issuer did not and will not issue new securities on or after October 12, 2012.
- The issuer will provide, upon request by the CFTC, within five business days (unless it shows that it cannot obtain the required documents through reasonable commercial efforts):
  - the most recent disclosure document used in connection with the offering of the securities issued by the vehicle in question;
  - all amendments to the principal documents since issuing the securities;
  - the most recent distribution statement furnished to investors; and
  - a copy of the information that would be provided to prospective investors to satisfy subsection (d)(4) of **Rule 144A** (17 C.F.R. § 230.144A(d)(4)), if applicable.

No-Action Letter 12-67: Relief for Investors in Legacy Securitization Vehicles
Further, on December 21, 2012, the CFTC issued No-Action **Letter** 12-67 (No-action 12-67), which extended the no-action relief discussed above to fund operators that invest in legacy vehicles. In No-action 12-67, the CFTC's Division of Swap Dealer and Intermediary Oversight (DSIO) recommended that the CFTC take no action against operators of funds that invest in legacy securitization vehicles for failure to register as CPOs if:

- The legacy securitization vehicle operator is entitled to no-action relief under the terms of No-action 12-45.
- The fund operator investing in the legacy securitization vehicle is not otherwise required to register as a CPO.

This no-action relief supplements the no-action relief previously provided under No-action 12-45 (see Permanent Relief for "Legacy Vehicles").

Temporary Relief for Nonconforming Securitization Vehicles

Finally, No-action 12-45 temporarily exempted from CPO registration operators of securitization vehicles that were unable to rely on the relief provided in No-actions 12-14 or 12-45. This no-action relief extended until March 31, 2013, which was the deadline for CPO registration for operators of these securitization vehicles.

No-action 12-45 also states that the CFTC remains open to considering whether securitization vehicles that do not meet the criteria set out in **Letter** 12-14 and No-action 12-45 might ultimately be exempted permanently from the definition of "commodity pool" or might otherwise be treated as an exempt pool.

Note that operators of nonconforming securitization vehicles were granted additional no-action relief by the CFTC, extending until June 20, 2013 the deadline for these CPOs to comply with CFTC CPO rules (see Legal Update, Temporary Relief for ABS CPOs Issued by CFTC).

This relief has expired, and nonconforming vehicles are now required to register as CPOs with the CFTC and adhere to all applicable CFTC CPO requirements.

Other CPO Exemptions

Fund-of-Funds CPO Exemption

The CFTC issued No-Action **Letter** 12-38 that provides temporary relief from its CPO registration requirements for fund of funds under CFTC regulations 4.5 and 4.13(a)(3) (17 C.F.R. §§ 4.5, 4.13(a)(3)), (see Legal Update, CFTC Issues No-Action Relief on Fund-of-Funds CPO Registration). To be eligible, the fund-of-funds operator must have filed a claim to "perfect the relief" before December 31, 2012. The relief remains in effect until the later of June 30, 2013 or six months after the CFTC issues revised guidance on the application to fund-of-fund operators of the calculation of de minimis thresholds.to fund-of-fund operators. No further guidance has been issued by the CFTC.

CPO Exemption for Insurance-Linked Securities

In CFTC No-Action **Letter** 14-152 (No-action 14-152), the CFTC provided no-action relief from registration as a CPO for entities engaging in insurance-linked securities (ILS) transactions. Under No-action 14-152, the CFTC's DSIO stated that it would not recommend that the CFTC take enforcement action against any entity characterized as the operator of an ILS CPO, for failure to register as a CPO under CEA Section 4m(1) (7 U.S.C. § 6m(1)), provided that the entity meets a number of enumerated requirements. For a list of those requirements and further background on No-action 14-152, see Legal Update, CFTC Issues CPO Relief for Insurance-Linked Securities.

Non-US CPO, CTA, and Introducing Broker Registration No-Action Relief

In CFTC No-Action **Letter** 16-08 (No-action 16-08), the CFTC provides no-action relief from Introducing Broker (IB), CTA, and CPO registration requirements under the CFTC. CFTC Regulation 3.10(c)(3)(i) (17 C.F.R. § 3.10(c)(3)(i)) provides an **exemption** for parties located outside the United States that enter into swaps on behalf of another non-US person and the transaction is submitted for clearing through a registered FCM. No-action 16-08 confirms that the registration **exemption** found in CFTC Regulation 3.10(c)(3)(i) does not impose any additional clearing requirement. For further details, see Legal Update, Certain Non-US Parties Exempt from CFTC Registration for Non-US Swaps.

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