CFTC Expands Regulation of Investment Companies

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February 17, 2012 – Last week, the CFTC amended its rules to roll back and dilute provisions that since 2003 have enabled most investment companies to use certain derivatives without having a commodity pool operator (CPO) registered with that agency. Under the amended rules, the requirements for avoiding CPO registration will continue to be somewhat different for SEC-registered investment companies (*e.g.*, mutual funds) than for private investment companies (*e.g.,* hedge funds). In either case, however, CPO registration may be required, unless, among other things, the investment company's use of commodity interests (including futures, options, and swaps) is below specified "*de minimis*" standards. The CFTC also clarified that, if CPO registration is required for an SEC- registered investment company, the investment adviser would be the CPO. For a private investment company, however, some other person (such as a general partner) might be the CPO, depending on the facts. December 31, 2012 is generally the compliance deadline for persons that the amendments require to register as CPOs for the first time. To facilitate CPO registration with respect to registered investment companies, the CFTC also proposed amendments last week to "harmonize" certain of its recordkeeping, reporting, and disclosure requirements with applicable SEC requirements. CFTC rules also provide certain recordkeeping, reporting, and disclosure relief for CPOs for private investment companies. Although such accommodations can reduce the additional costs and burdens associated with being a registered CPO, those costs and burdens may still be substantial. Both registered and private investment companies will need to carefully consider numerous questions raised by last week's amendments, including whether CPO registration will be required and whether the attendant regulatory and disclosure costs merit submission of comments to the CFTC on its above-mentioned harmonization proposal. In addition, some investment companies and their sponsors may decide to modify fund investment strategies or change the line-up of available funds, in order to avoid CPO registration. The amended rules also require that all persons claiming an exclusion or exemption from CPO registration annually affirm the notices that they file for that purpose with the National Futures Association (NFA). Until now, such notices have been required to be updated only if they became inaccurate or incomplete. The new annual affirmation requirement will apply even to persons who, notwithstanding last week's CFTC amendments, continue to satisfy the requirements for exclusion or exemption. The first annual affirmation must be filed with the NFA by March 1, 2013. *Insurance Company Separate Accounts* Insurance companies commonly operate separate accounts without CPO registration in reliance on a specific exclusion that is different from the above-discussed provisions that apply to investment companies. Last week's CFTC amendments do not modify the terms of this separate account exclusion, except that the new annual affirmation requirement will apply. Thus, insurance companies that are relying on the exclusion for separate accounts will need to file their first annual affirmation with the NFA by March 1, 2013. Also, insurance company separate accounts commonly invest in registered or private investment companies, and many of these underlying funds may be affected by last week's amendments. Among other things, affected funds may decide to significantly change their use of commodity interests or even to liquidate or merge. Insurance companies will need to coordinate with underlying fund advisers (whether or not affiliated with the insurance company) concerning what changes, if any, each fund will be making. In turn, insurance companies may find it necessary or advisable to review and possibly alter the menus of underlying funds offered under their products, and/or make certain changes in their disclosure documents. While December 31, 2012 seems distant now, the time required for analysis and implementation of any changes makes it important for investment companies and insurance companies to get started promptly. Insurance companies may find the deadline especially pressing, to the extent that analysis and implementation of any separate account changes must await decisions or implementation at the underlying fund level.

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