



CFTC Issues Relief to CPOs in Response to JOBS Act General Solicitation Amendments, but Uncertainties Remain

September 12, 2014

On September 9, 2014, the Division of Swap Dealer and Intermediary Oversight (the “Division”) of the Commodity Futures Trading Commission (the “CFTC” or the “Commission”) issued exemptive relief (the “Exemptive Relief”) intended to allow most investment managers of investment pools (including private equity and hedge funds) that invest in commodity instruments (including swaps) and rely on the most common CFTC registration and compliance exemptions to engage in general solicitation by effectively conforming the CFTC rules that provided for these exemptions to the previously adopted amendments by the Securities and Exchange Commission (the “SEC”) pursuant to the Jumpstart Our Business Startups Act (the “JOBS Act”) to Rule 506 of Regulation D and Rule 144A under the Securities Act of 1933 (as amended, the “Securities Act” and such amendments, collectively, the “JOBS Act Amendments”).¹ While the Exemptive Relief is certainly good news for investment managers seeking to engage in general solicitation, a number of related uncertainties remain outstanding for such managers, as indicated below.

BACKGROUND OF JOBS ACT AMENDMENTS

As part of the JOBS Act Amendments, the SEC adopted a new clause (c) to Rule 506, a non-exclusive safe harbor under Section 4(a)(2) of the Securities Act that permits the use of general solicitation and general advertising in connection with a private securities offering made in reliance upon Rule 506, so long as certain conditions are met.² In addition to the new Rule 506(c), the JOBS Act Amendments also eliminated restrictions on offerings pursuant to Rule 144A, requiring only, in addition to the other Rule 144A conditions that remained unchanged, that securities are sold to qualified institutional buyers (“QIBs”) or to purchasers that the seller and any person acting on behalf of the seller reasonably believes are QIBs. While the JOBS Act Amendments permit certain private offerings of securities pursuant to Rule 506(c) or Rule 144A to be conducted using general solicitation and advertising, such solicitation and advertising remains prohibited when claiming an exemption under Section 4(a)(2) of the Securities Act and what is now Rule 506(b) of Regulation D.

¹ For the full text of the release providing the exemptive relief, please see:
<http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-116.pdf>.

² For the full text of the release adopting the amendments to eliminate the prohibition on general solicitation and general advertising in connection with private offerings made in reliance upon Rule 144A and Rule 506, please see:
<http://www.sec.gov/rules/final/2013/33-9415.pdf>.

CFTC REGULATION OF COMMODITY POOLS

Unless an exclusion or exemption from registration is available, operators of investment pools that engage, directly or indirectly, in any transactions in futures, commodities, or certain types of over-the-counter foreign exchange products and swaps (collectively, “commodity interests”) are subject to regulation by, and registration with, the CFTC (such operators, “CPOs” and such pools “commodity pools”).³ While holding a single commodity interest is sufficient to make an investment vehicle a commodity pool, there is a *de minimis* exemption from registration for its CPO pursuant to CFTC Regulation 4.13(a)(3). To qualify for registration relief under CFTC Regulation 4.13(a)(3), the relevant commodity pool must meet one of two alternative tests concerning the limited size of its commodity interest positions, among other requirements.⁴ Prior to the Exemptive Relief, the CPO could not engage in marketing to the public and avail itself of this exemption.⁵

As an alternative, CFTC Regulation 4.7 provides limited relief to registered CPOs from certain disclosure, reporting, and recordkeeping requirements. Under Regulation 4.7(b), such relief is available only to (i) a registered CPO who *offers* or sells participations in a pool solely to qualified eligible persons in an offering that qualifies for an exemption from the registration requirements of the Securities Act pursuant to Section 4(a)(2), as amended by the JOBS Act, or Regulation S or (ii) any bank registered as a CPO in connection with a pool that is a collective trust fund whose securities are exempt from registration under the Securities Act pursuant to Section 3(a)(2) and are offered or sold, *without marketing to the public*, solely to qualified eligible persons.

Before the Exemptive Relief, CPOs relying on CFTC Regulations 4.7 and 4.13(a)(3) were effectively prohibited from engaging in the general solicitation and general advertising, which may have otherwise been permitted pursuant to the JOBS Act Amendments. Accordingly, notwithstanding the historic implications of lifting the ban on general solicitation and advertising, the practical effect of the JOBS Act Amendments on marketing activities has been limited due to this and other uncertainties.

EXEMPTIVE RELIEF

In order to harmonize existing CFTC Regulations with the general advertising and general solicitation relief provided by the JOBS Act Amendments, the staff of the CFTC determined that it was appropriate to grant exemptive relief. Subject to the conditions outlined below, the Exemptive Relief provides that CPOs which are relying on the JOBS Act Amendments to generally solicit or advertise their offerings are exempt:

³ Readers who are interested in the possible impact of the registration and compliance obligations of commodity pool operators should also refer to our memorandum “New CFTC Guidance on Registration and Compliance Obligations for CPOs and CTAs”, which can be accessed at: <http://www.stblaw.com/docs/default-source/cold-fusion-existing-content/publications/pub1450.pdf>.

⁴ See CFTC Regulation 4.13(a)(3)(ii).

⁵ See CFTC Regulation 4.13(a)(3)(i).

- I. from the requirements in CFTC Regulation 4.7(b) that the offering of interests in the commodity pool be exempt from the registration requirements of the Securities Act pursuant to Section 4(a)(2) and be offered solely to qualified eligible persons; and
- II. from the requirement in CFTC Regulation 4.13(a)(3) that the interests in the commodity pool are offered and sold without marketing to the public in the United States.

Importantly, the Exemptive Relief is not self-executing. In order to claim the Exemptive Relief, a CPO must file a notice via email with the Division including the following, among other information:

- I. basic information regarding the CPO and the commodity pool for which the claim is filed;
- II. a statement as to whether the CPO claiming the relief is relying on Rule 506(c) or is using resellers under Rule 144A; and
- III. a statement as to whether the CPO intends to rely on CFTC Regulation 4.7 or 4.13(a)(3) with respect to the commodity pool, as well as a representation that the CPO meets the remaining requirements of the relevant Regulation.

So long as a claim for relief is materially complete and accurate, it will be effective upon filing.

It should be noted that the Exemptive Relief is targeted to 506(c) offerings and is not available for Section 4(a)(2) or other Regulation D offerings, which sponsors are likely to continue to rely on. Furthermore, the Exemptive Relief is temporary and the Division expressly stated that its position on this subject may change, which could make the Exemptive Relief void in the future.⁶

REMAINING UNCERTAINTIES

General Solicitation Uncertainties

As indicated in our previously released memorandum,⁷ there are a number of outstanding concerns for managers seeking to engage in general solicitation, apart from increased compliance costs and burdens, including with respect to (i) uncertainty as to the interpretation of the required verification process for eligibility of investors for the relevant investment vehicle, (ii) the effect on eligibility for applicable exemptions and compliance obligations with respect to state and foreign securities regulations which may be predicated on not engaging in general solicitation or advertising and (iii) uncertainty with respect to whether proposed rules

⁶ Exemptive Relief from Provisions in Regulations 4.7(b) and 4.13(a)(3) Consistent with JOBS Act Amendments to Regulation D and Rule 144A, CFTC Letter No. 14-116 (September 9, 2014) at 8.

⁷ Our Memorandum, "SEC Adopts Rules to Eliminate Prohibition Against General Solicitation and Advertising in Certain Private Securities Offerings; Also Proposes New, Related Investor Protection Requirements – Private Investment Funds Perspective", can be accessed at: <http://www.stblaw.com/docs/default-source/cold-fusion-existing-content/publications/pub1629.pdf?sfvrsn=2>.

that would require, among other things, filings with and potential review by the SEC, including submission of general solicitation materials to the SEC, will be adopted at all or in what form.

Commodity Trading Advisors

The Exemptive Relief did not address commodity trading advisors (“CTAs”) that rely on certain exclusions and exemptions from registration (e.g., Rule 4.14(a)(10)), which condition such relief on not holding out generally to the public as CTAs. As a result, engaging in general solicitation could potentially require the relevant CTA to register with the CFTC or rely on another exemption from registration.

CONCLUSION

While the Exemptive Relief removes a significant obstacle for asset managers looking to engage in general solicitation, there remain uncertainties with respect to the regulation of such activities by both the SEC and the CFTC that should be considered prior to engaging in general solicitation.

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For more information about any of the foregoing, please contact a member of the Firm’s Private Funds Group.

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