

**MEMO# 15821**

March 28, 2003

## **CFTC PROPOSES REVISED AMENDMENT TO RULE 4.5 AND AFFIRMS PREVIOUS NO-ACTION RELIEF**

[15821] March 28, 2003 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 21-03 COMPLIANCE ADVISORY COMMITTEE No. 27-03 SEC RULES COMMITTEE No. 30-03 RE: CFTC PROPOSES REVISED AMENDMENT TO RULE 4.5 AND AFFIRMS PREVIOUS NO-ACTION RELIEF

As we previously informed you, in October 2002, the Commodity Futures Trading Commission (CFTC) proposed for comment an amendment to Rule 4.5 under the Commodity Exchange Act, which provides a conditional exclusion from the definition of “commodity pool operator” (CPO) to certain regulated entities, including registered investment companies.<sup>1</sup> The CFTC’s proposal also provided no-action relief, effective immediately, to allow eligible persons to rely on the amendment to Rule 4.5, pending final action on the proposal. Based upon comments received on its proposal, and testimony received during a recent CFTC-sponsored roundtable on issues relating to CPOs and commodity trading advisors (CTAs), the CFTC has withdrawn its previously proposed amendment to Rule 4.5 and published a revised proposed amendment for comment.<sup>2</sup> In its current release, which is summarized below, the CFTC also affirms that eligible entities may continue to rely on the no-action relief it provided last October pending final action on any rule amendment. Comments on the proposal must be filed with the CFTC by May 1, 2003. If there are issues you would like the Institute to consider addressing in its comment letter, please contact the undersigned by Friday, April 11th by phone (202-326-5825) or e-mail (tamara@ici.org). The amendment the CFTC proposed to Rule 4.5 in October 2002 was intended to address concerns with the provisions in the rule that limit the aggregate initial margin and premiums required to establish non-hedge positions to five percent of the liquidation value of 1 See Institute Memorandum No. 15304, dated October 28, 2002. The Institute filed a letter supporting the proposed amendments. See Institute Memorandum 15399, dated November 27, 2002. Rule 4.5 permits investment companies and other specified entities to trade commodity futures and options thereon without having to register with the CFTC as a CPO if they file a notice making certain representations related to their commodity trading activities. 2 See 68 Fed. Reg. 12622 (Mar. 17, 2003). The CFTC’s current release also (1) proposes amendments to Rules 4.13 and 4.14, which provide exemptions from CPO and CTA registration, to expand the availability of the relief provided by these rules, and (2) proposes amendments to several other requirements for CPOs and CTAs. These proposals are not discussed in this memorandum. 2 the entity’s portfolio (the “five percent test”). These concerns arose from the fact that the margin levels for certain stock index futures and security futures products may significantly exceed five percent of the contract value. To address these concerns, the CFTC proposed as an alternative to the five percent test a “notional value” test, and issued no-action relief that would permit registered

investment companies and other eligible persons to take advantage immediately of this new alternative test. Based upon additional input the CFTC has received since its October proposal, it has determined that, inasmuch as the persons provided relief by Rule 4.5 are “otherwise regulated,” such persons need not be subject to any commodity interest trading criteria (i.e., neither the five percent nor the notional value test) in order to qualify for the rule’s relief. In addition, the CFTC believes that deleting such criteria from the rule may render obsolete the disclosure currently required by the rule. Accordingly, the CFTC has proposed to delete the five percent test (and the notional value test) and the disclosure requirements from Rule 4.5. As such, the only conditions eligible institutions would be required to meet to satisfy the rule are: (1) a prohibition against marketing a qualifying entity as a commodity pool or otherwise as a vehicle to trade commodity interests; and (2) a requirement to submit to special calls to demonstrate compliance with eligibility for relief under Rule 4.5. Until such time as these amendments are adopted, however, persons relying on Rule 4.5 must continue to satisfy either the rule’s five percent test or the alternative notional value test set forth in the CFTC’s October 2002 no-action relief.<sup>3</sup> The CFTC’s release states that eligible persons who have claimed or will claim such relief in the future do not need to take any additional action to operate their qualifying entity in accordance with the notional test. Instead, making the representations currently required by the rule, including the representation concerning the five percent test, is all that is required. This relief will remain in effect until such time as the CFTC takes final action on the amendment it has proposed to Rule 4.5. Tamara K. Salmon Senior Associate Counsel 3

In response to comments on its October 2002 proposal, the CFTC’s release clarifies certain issues regarding how and when compliance with the notional value test is measured.