

LEGAL UPDATE

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CFTC STAFF REMOVES OBSTACLE TO PRIVATE INVESTMENT FUND GENERAL SOLICITATIONS UNDER THE JOBS ACT

Over a year after the Securities and Exchange Commission (the “SEC”) amended Rule 506 of Regulation D and Rule 144A to implement Sections 201(a)(1) and 201(a)(2) of the JOBS Act¹, the Commodity Futures Trading Commission (the “CFTC”) staff has responded with an effort toward harmonization. By issuing CFTC Letter 14-116 on September 9, 2014, the CFTC staff has made relief available to commodity pool operators (“CPOs”) from having to meet certain conditions in order to rely on CFTC Rules 4.7(b) and 4.13(a)(3). The CFTC staff’s action is intended to resolve discrepancies between exemptive relief provisions under the CFTC’s regulatory regime and the exemptive relief provisions under the Securities Act of 1933, as amended (the “Securities Act”), by expanding the scope of permitted communications and use of advertising in connection with the offer and sale of private funds that are commodity pools.

BACKGROUND

CFTC Rule 4.7 provides relief from certain of the otherwise required disclosure, periodic and annual reporting, and recordkeeping requirements to CPOs who claim the relief pursuant to Rule 4.7(d). Under Rule 4.7(b), a registered CPO may claim exemptive relief if (i) it offers or sells participations in a pool solely to qualified eligible persons (“QEPs”)² in an offering which qualifies for exemption from the registration requirements of the Securities Act pursuant to Section 4(a)(2) or Regulation S, or (ii) it is a bank that acts as CPO in connection with a pool that is a collective trust fund whose securities are exempt from registration pursuant to Section 3(a)(2) of the Securities Act and are offered or sold, without marketing to the public, solely to QEPs. CFTC Rule 4.13(a)(3) provides a registration exemption for CPOs where (i) the interests in each pool for which the CPO is claiming the exemption are exempt from registration under the Securities Act and are “offered and sold without marketing to the public in the United States,” (ii) each of the pools for which the CPO is claiming the exemption is a commodity pool with *de minimis* commodity interest exposure, (iii) the CPO reasonably believes at the time of investment that each person who participates in such pool is, among other things, a QEP or an accredited investor, and (iv) the participations in the pool are not marketed as or in a vehicle for trading in the commodity futures or commodity options markets.

Rule 506 under Regulation D was amended in accordance with JOBS Act Section 201(a)(1) to add Rule 506(c), which permits an issuer to engage in general solicitation and general advertising in offers and sales of its

¹ Jumpstart Our Business Startups Act, H.R. 3606, 112th Congress (2011) (the “JOBS Act”). For additional information, please see the Pryor Cashman Legal Update entitled “*SEC Proposes Rules Effecting the JOBS Act’s Elimination of the General Solicitation Ban in Private Offerings*”, available here: <http://www.pryorcashman.com/assets/attachments/842.pdf>; See also Pryor Cashman Legal Update entitled “*The Path Opens for Advertising in Rule 506 and Rule 144A Offerings: SEC Proposes Rules Effecting the JOBS Act’s Elimination of the General Solicitation Ban in Private Offerings*”, available here: <http://www.pryorcashman.com/assets/attachments/854.pdf>, and Pryor Cashman Legal Update entitled “*SEC Adopts Significant Changes to Rule 506 to Permit General Solicitation and to Disqualify ‘Bad Actors’*”, available here: <http://www.pryorcashman.com/assets/attachments/975.pdf>.

² As defined in CFTC Rule 4.7(a)(2) and (3).

securities pursuant to Rule 506, provided that the issuer meets the following conditions: (i) the terms and conditions of Rules 501 and 502(a) and (d) must be satisfied; (ii) all purchasers of the securities must be accredited investors; and (iii) the issuer must take reasonable steps to verify that purchasers are accredited investors. Rule 144A was amended in accordance with JOBS Act Section 201(a)(2) to eliminate references in Rule 144A(d)(1) to “offer” and “offeree”, such that this provision now permits securities to be offered pursuant to Rule 144A to persons other than qualified institutional buyers (“QIBs”) provided that the securities are in fact sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are QIBs; the SEC explained in the Adopting Release that “under this amendment, resales of securities pursuant to Rule 144A can be conducted using general solicitation, so long as purchasers are limited in this manner.”³

Because the CFTC exemptions under Rule 4.7(b) and 4.13(a)(3) restricted offers as well as sales of interests in the relevant commodity pool, these CFTC exemptions have prevented most CPOs from taking advantage of the ability to engage in advertising pursuant to Rule 506(c) or Rule 144A under the Securities Act out of concern that they would lose the exemptions available to them under the CFTC’s rules. This discrepancy between the SEC’s and the CFTC’s exemption regimes created uneven regulatory requirements across different types of private investment funds, with no apparent regulatory rationale. In particular, hedge funds that trade commodity interests (including swaps on broad-based securities indices) were not able to provide information to the public in connection with their marketing, but most private equity funds, which do not trade commodity interests, were able to use advertising and general solicitations to market. Similarly, a hedge fund that invests exclusively in single-security swaps might have been able to engage in a general solicitation to offer its securities while a hedge fund that trades similarly but also invests in swaps on broad-based securities indices would have been prohibited from engaging in a general solicitation.

EXEMPTIVE RELIEF

The CFTC staff’s exemptive letter provides relief, subject to certain conditions, from the requirements under CFTC Rule 4.7(b) that an offering be exempt pursuant to Section 4(a)(2) of the Securities Act and be offered solely to QEPs, and from the requirement under Rule 4.13(a)(3)(i) that securities be “offered and sold without marketing to the public.” First, the exemptive relief is available only for issuers relying on Rule 506(c) or resellers relying on Rule 144A. Second, the relief is not self-executing, and requires that a CPO file a notice with the CFTC’s Division of Swap Dealer and Intermediary Oversight in order to claim relief under the exemptive letter. This notice must be filed by an email to the address dsionoaction@cftc.gov with “JOBS Act Marketing Relief” in its subject line.

The notice of claim of exemptive relief must be signed by the CPO claiming the relief, and must include the following: (i) name, business address, and primary business telephone number of the CPO claiming relief; (ii) name of the commodity pool(s) for which the claim is being filed; (iii) a statement of whether the commodity pool for which the CPO is claiming relief is a 506(c) issuer or is using one or more 144A resellers;⁴ and (iv) a statement specifying on which exemption the CPO intends to rely with respect to the pool(s) -- Rule 4.7(b) or Rule 4.13(a)(3) – and affirmative representations that the CPO meets all of the conditions of the applicable exemption other than the condition regarding the manner of the offer. The exemptive relief offered under CFTC Letter 14-116 will remain in effect until the effective date of any final CFTC action in consideration of the JOBS Act and the SEC’s regulatory amendments to Regulation D and Rule 144A pursuant to the JOBS Act.

IMPACT AND CONSEQUENCES

The alternative assets community has responded slowly to the path to general solicitation that was first revealed in the JOBS Act and opened with the SEC’s adoption of Rule 506(c) under Regulation D. Certainly one reason for this tentativeness was the continuing restriction on public marketing in CFTC Rules 4.7 and 4.13(a)(3), on which hedge fund managers frequently rely. The CFTC staff’s exemptive letter will give hedge funds and their

³ See Adopting Release, 78 Fed. Reg. at 44786.

⁴ CFTC Letter 14-116 says that the exemptive notice must “[s]tate whether the CPO claiming the relief is a 506(c) Issuer... .” Typically, however, the issuer relying on Regulation D will be the private investment fund (*i.e.*, the commodity pool) rather than its CPO, which would usually be the general partner, manager, or, in some circumstances, the investment adviser to the issuer.

managers a reason to review again whether they would benefit from more expansive marketing and what verification and other procedures they would have to implement to do so.

At the same time, this exemptive letter also serves as a reminder that in taking a higher profile private investment funds must move cautiously and with full analysis of regulatory implications. For example, while some commentators have previously suggested that Rule 4.7 might be available with respect to a commodity pool that engaged in general solicitations permitted under Rule 506(c), the CFTC staff has made clear that, in their view, in the absence of the recent exemptive letter, Rule 506(c) issuers would be prevented from receiving any exemptive relief provided to CPOs by Rule 4.7(b)(1)-(4). Moreover, in noting that the exemptive letter provides relief only in the interim before the CFTC takes final action in regard to commodity pools' use of general solicitation, the CFTC staff raises the prospect that alternative investment advisers and the funds they manage may need to further adjust their policies and procedures when the final rules are adopted. Rather than fully opening the path to public marketing of private investment funds, the CFTC staff's exemptive letter is simply the next step in the process and may in fact encourage further hesitance, with the alternative investment industry waiting until final rules are adopted.

The foregoing is merely a discussion of certain elements of the CFTC's regulations applicable to private investment funds. If you would like to learn more about this topic or how Pryor Cashman LLP can serve your legal needs, please contact Bertrand C. Fry at bfry@pryorcashman.com or Nir E. Gozal at ngoza1@pryorcashman.com.

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Bertrand Fry is a partner in Pryor Cashman's Corporate Group and is co-head of the firm's Investment Management Group. Bert has over twenty years of general corporate and transactional experience that includes extensive experience with alternative investment vehicles. In addition to having launched and advised a diverse array of U.S. and non-U.S. investment products, including vehicles engaged in macro, distressed, private equity, venture capital, and real estate investing, debt origination, and quantitative trading of securities and futures, his practice has included, among other things, structuring and advising investment managers and advisers, private company mergers & acquisitions, and joint ventures.

Bert is particularly well attuned to the business needs of his clients, based on more than a decade of in-house experience at the D. E. Shaw group, where Bert was a Senior Vice President and served for a period as Acting General Counsel. During his tenure there, the D. E. Shaw group included several SEC-registered investment advisers and, at its apex, managed approximately \$40 billion across various strategies and multiple funds. Bert also launched and advised a wide range of hedge funds, funds of funds, and their managers as a member of the London office of Dechert LLP.

Bert earned his A.B., with honors, from the University of Chicago and his J.D., with honors, from The University of Texas at Austin School of Law, where he was also an articles editor for the Texas Law Review and received the Outstanding Second-Year Member Award from the Texas Law Review, the Gilbert I. Low Endowed Presidential Scholarship in Law, and Highest Achievement in Contracts.

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