September 10, 2003

Memorandum

Amendment to Commodity Futures Trading Commission Regulations

On August 1, 2003, the Commodity Futures Trading Commission (the "Commission") approved amendments to various Commission regulations relating to, among other issues, registration as a commodity pool operator ("CPO"). The amendments supersede the No-Action Relief previously issued by the Commission and are effective immediately.

New Exemptions from CPO Registration

The first exemption (Rule 4.13(a)(3)) applies to private investment funds whose participants are accredited investors, knowledgeable employees, non-U.S. persons and certain family trusts formed by accredited investors. A fund manager claiming this exemption is required to operate the fund such that it meets one of the following trading limitations at all times: (1) the aggregate initial margin and premiums required to establish commodity positions will not exceed 5% of the liquidation value of the fund's portfolio after taking into account unrealized profits and losses on any such positions (provided that with respect to an option that is in-the-money at the time of purchase, the in-the-money amount may be excluded in computing the 5%) or (2) the aggregate net[1] notional value[2] of such positions will not exceed 100% of the liquidation value of the fund's portfolio after taking into account unrealized profits and losses on any such positions. The amendment expands the 2% and 50% limitations of the No-Action Relief issued in a previous release.

Both of the above trading limitations apply to commodity positions whether or not entered for hedging purposes and both limitations are to be determined at the time the most recent position was established. The application of the trading limitations to fund-of-fund managers is discussed below.

The second exemption (Rule 4.13 (a)(4)) applies to private investment funds in which (1) each participant that is a natural person is a "qualified purchaser" (generally, a person owning investments of not less than $5 million), knowledgeable employee (including principals of the manager) or a non-U.S. person and (2) each participant that is a non-natural person is either a "qualified eligible person" (generally, owning a securities portfolio of at least $2 million), an accredited investor (generally, having assets in excess of $5 million) or a non-U.S. person or entity. There is no trading limitation under this exemption.

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1 The fund manager may net contracts with the same underlying commodity across designated contract markets, registered derivatives transaction execution facilities and foreign boards of trade.

2 Notional value is computed by multiplying the number of contracts by the size of the contract, in contract units (taking into account any multiplier specified in the contract), by the current market price per unit. For options on futures, multiply the number of contracts by the size of the contract, adjusted by its delta, in contract units (again taking into account any multiplier specified in the contract), by the strike price per unit.

A manager that wants to take advantage of either of the above exemptions must file a notice of exemption from registration with the National Futures Association ("NFA") and provide to its investors certain disclosure relating to the requirements of the exemption. The notice will be effective upon filing. A manager may file a notice under one of the exemptions with respect to a particular fund and not be precluded from claiming the other exemption with respect to a different fund. In addition, a manager who is registered as a CPO may file a notice with respect to certain funds, while maintaining its registration with respect to other funds, and will be subject to Commission rules only with respect to the funds for which it is registered. A manager so registered must notify investors in its exempt funds that it will operate those funds as if the manager were exempt from registration and provide those investors with disclosure relating to the terms of the exemption.

Any manager that files a notice under the new exemptions will be required to maintain books and records relating to its commodity trading and will be subject to any special calls that the Commission may impose relating to eligibility for, and compliance with, the applicable exemption.

Effect on Registered CPOs and Existing Pools

A manager that is currently registered as a CPO may withdraw its registration and file a notice of exemption with the NFA, provided that the manager notifies investors of its intent to deregister and permits them to withdraw from the fund prior to filing the notice. The manager will be required to file with the NFA and distribute to investors, an annual report for the year in which its withdrawal is effected, will be required to maintain certain books and records and will be subject to special calls of the Commission, as discussed above.

Further, a manager of an existing fund that decides to maintain its registration on behalf of certain funds may rely on the new exemptions with respect to other funds for which it was previously required to be registered, provided that prior to operating such a fund under the new exemption, it notifies investors of their right to withdraw from such fund.

Effect on Managers Who Have Claimed "No-Action Relief"

Managers who claimed temporary No-Action Relief under either of the prior Commission releases are not required to file a new notice in order to take advantage of the relief provided in the new exemptions. In addition, if the manager continues to comply with the trading limitations applicable to the previously filed notice, no other action is required in order for the manager to claim either of the new exemptions, but all other requirements of the applicable exemption apply. However, if the manager intends to take advantage of the expanded trading limitations, additional disclosure to investors relating to such limitations will be required.

Application of Trading Limitations for Fund-of-Fund Managers

The Commission has adopted a new "Appendix" to the registration rules that clarifies how the trading limitations of Rule 4.13(a)(3) apply to fund-of-fund managers. The Appendix includes six situations and explains how a fund-of-fund manager should determine compliance with the trading limitations, assuming that the manager meets all the other requirements of the exemption. A fund-of-fund manager who does not fall within one of the six situations should contact the Commission to discuss the applicability of the trading limitations to its particular situation.

Generally, a fund-of-funds manager (an "Investor Fund") can file a notice of exemption where:

- each manager of an underlying fund (each, an "Investee Fund") that trades futures is itself claiming exemption under Rule 4.13(a)(3) or is a registered CPO who is complying with the trading limitations of 4.13(a)(3);
- the manager of the Investor Fund knows the trading and commodity interests positions of the Investee Funds (for example, where the Investee Funds are under common control with the Investor Fund) and can therefore aggregate the commodity positions of the Investee Funds to determine its own compliance with the trading limitations;
- the Investor Fund does not trade commodity interests directly and invests no more than 50% of its assets in Investee Funds that trade futures (regardless of the amount of commodity trading engaged in by the Investee Funds); or
- the Investor Fund does engage in commodity trading directly, in addition to allocating assets to Investee Funds, as long as the manager of the Investor Fund treats the portion of its assets that it commits directly to futures as a separate pool with its own liquidation value, and applies the trading restrictions to that separate pool, as well as to the portion of the fund allocated to Investee Funds.

Summary of Other Changes

The amendments also include changes with respect to the following:

- additional exemptions from registration for commodity trading advisors, including an exemption for (a) certain investment advisers that provide advice only to specific types of entities and (b) commodity trading advisors that provide advice to fund managers who claim relief under the new exemptions;
- elimination of the duplicative filing requirements for master-feeder funds, so that a master fund is no longer required to distribute periodic and annual reports to the feeder or to claim an exemption therefrom;
- elimination of the trading and marketing restrictions applicable to managers providing advice to "qualifying entities" under Rule 4.5;
- revisions to the signature requirements so that any person authorized to bind a Commission registrant may sign documents required to be filed with the Commission or the NFA (including the oath that must appear on periodic and annual statements);
- revisions to the rules regarding presentation of past performance, including (a) disclosure of the range of rates of return for closed accounts, (b) computation of program draw-down information on a composite basis, and (c) methods to account for intramonth additions and withdrawals in the computation of rate of return;

- permitting communications with prospective investors prior to delivery of the disclosure documents as long as the disclosure documents are delivered not later than the subscription agreement (provided that the disclosure documents do not materially amend the prior information); and

- permitting periodic and annual statements to be transmitted electronically to investors with a facsimile signature upon prior notice to, and absent objection from, the investor, provided an original signature is (a) filed with NFA or the Commission and (b) kept in the office of the registrant.

If you have any questions regarding the new exemptions from registration or any of the other amendments, please contact an attorney in the Investment Management Group at Seward & Kissel. In addition, the amendments can be accessed at www.cftc.gov.

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