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ALERT

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CFTC Removes Big Obstacle to Hedge Fund Advertising

On September 9, 2014, the U.S. Commodity Futures Trading Commission ("CFTC") eased long-standing marketing restrictions on private offerings by hedge funds, a move aimed at aligning the CFTC's restrictions with similar rules adopted by the U.S. Securities and Exchange Commission ("SEC") last year.

Relying upon authority provided in the Jumpstart Our Business Startups Act (the "JOBS Act"), the SEC last year lifted a longstanding advertising ban for hedge funds and other firms that raise cash through certain types of private placements. The relief allows a private fund that sells only to accredited investors to use general solicitation to obtain investors so long as the fund verifies the accredited status of the investors by means that go beyond self-certification by the investor.

However, many hedge funds were unable to take advantage of the eased SEC rules because many funds were still barred from public advertisements under separate CFTC rules that apply to funds that engage in commodities trading, as many funds do. The CFTC's move to ease those restrictions and make them similar to the SEC's comes after more than a year of lobbying by the hedge fund industry.

Technically, the CFTC removed the prohibition on public offerings by funds that rely upon two exemptions important to private funds:

> Regulation 4.13(a)(3), which allows funds that sell only to accredited investors to invest up to certain thresholds in commodities without the requirement to register as a commodity pool operator ("CPO").

> Regulation 4.7(b), which allows registered CPOs that sell only to certain qualified investors to avoid many filing requirements otherwise applicable to CPOs.

Unlike SEC exemptions, the CFTC's relief is not self-executing. Funds that want to rely upon the relief would have to file a notice with the CFTC that they plan to advertise. The exemptive relief granted is

strictly limited to managers who are relying on the SEC's Regulation D Rule 506(c) exemption adopted last year that allows advertising under the Securities Act of 1933. Additionally, a manager relying on CFTC Rule 4.13(a)(3) still could not market the pool as a vehicle for commodity futures or options trading.

While this is very welcome relief, please be aware of a number of remaining issues before any rush to advertise.

While the SEC has issued some guidance since last year, the required verification of accredited status represents an enormous operational challenge for funds and requires new procedures and due diligence for funds that choose to advertise.

The permissive SEC rules also do not override the private placement regimes of other countries, and it is possible that various types of general solicitations conducted within or from the United States (such as the use of unrestricted websites) may be deemed a violation of the private placement rules in another country.

Further, sponsors of private funds should be aware that if they advertise broadly as they are now allowed, they will not be able to fall back on the exemption from registration under Section 4(a)(2) of the Securities Act of 1933 if they fail to satisfy the narrower Rule 506(c) exemption under which advertising is permitted. Moreover, alternative state blue sky exemptions for private offerings and state investment adviser or foreign private adviser exemptions based on "not holding out" may be unavailable for offerings that engage in general solicitation.

Other uncertainties remain to the extent there are a number of amendments to SEC rules relating to general solicitation offerings that have been proposed but not yet adopted, including a requirement to pre-file general solicitation materials. In addition, the SEC has indicated that the use of general solicitation by fund managers will likely increase the risk of SEC examination. Advisers also would have to amend their Form D filings to report that they are advertising.

The CFTC guidance is interim relief. If and when formal rulemaking to address this topic is instituted, it is possible that there could be additional disclosure or substantive requirements.

Finally, integration issues may remain for multiple concurrent offerings, and antifraud rules and specific advertisement content rules, especially for registered advisers, still apply.

Registered investment advisers also need to remember they can only charge incentive compensation to investors meeting the higher "qualified client" standards.

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