

Client Alert

October 2012

CFTC No-Action Letters

On October 11, 2012, the U.S. Commodity Futures Trading Commission (CFTC) issued two interpretive letters and today, issued a no-action letter. The letters were issued to the National Association of Real Estate Investment Trusts (NAREIT), the American Securitization Forum (ASF) and certain persons designated as swap persons and ICE/NYMEX contract persons, respectively.

[The NAREIT letter](#) applies only to equity REITs, which are REITs that identify themselves as equity REITs on their tax returns (or, for REITs that have not filed their first tax returns, their offering documents). This is a “bright-line” test. The NAREIT letter does not apply to mortgage or hybrid REITs. Equity REITs are not considered to be commodity pools.

[In the ASF letter](#), CFTC rejected ASF’s request for relief in respect of covered bonds, collateralized debt obligations (CDOs), collateralized loan obligations (CLOs), insurance risk securitizations and synthetic securitizations. However, it granted ASF’s request in respect of securitizations (ABS/MBS) satisfying certain criteria. The criteria for relief is as follows:

1. The ABS/MBS issuer must be operated consistent with Reg. AB (i.e., Securities and Exchange Commission (SEC) disclosure rules) or rule 3a-7 (i.e., an SEC exemption from the Investment Company Act of 1940 or '40 Act), whether or not the ABS/MBS is publicly or privately offered and whether or not the issuer used a different '40 Act exemption, as long as the pool assets and the ABS/MBS satisfy the requirements of either set of rules.
2. The issuer’s activities are limited to passively owning or holding a pool of receivables or other financial assets (excluding transactions such as synthetics in which the issuer obtains exposure to assets that are not transferred or otherwise part of the asset pool) that are fixed or revolving (master trusts are permitted subject to Reg. AB compliance) and that by their terms convert to cash within a finite time period (including leased asset residuals consistent with Reg. AB), plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to security holders.
3. The issuer’s use of derivatives is limited to those uses permitted by Reg. AB, including credit enhancement and the use of derivatives like rate and currency swaps to alter cash flow payment characteristics.
4. The issuer makes payments to security holders only from cash flow generated by pool assets and other permitted rights and assets and not from or otherwise based on changes in the value of the issuer’s assets.
5. The issuer is not permitted to acquire additional assets or dispose of assets for the primary purpose of realizing gain or minimizing loss due to changes in market value of the assets, though an issuer may enter into new swaps as may be necessary to address counterparty downgrade or default.

ABS/MBS that satisfy the foregoing criteria are not considered to be commodity pools. Asset-backed commercial paper (ABCP) and other securitization types not explicitly rejected for relief as described

above also are not explicitly granted relief in the ASF letter. However, they must satisfy the foregoing criteria for relief to apply. Nonetheless, CFTC states that securitization vehicles not having multiple equity participants, not making profit and loss allocations and issuing only debt and debt-like interests with a stated coupon, principal balance and specific maturity date are likely not commodity pools and that CFTC remains open to considering relief for securitizations that are not covered by the ASF letter.

Significantly, entities that are not commodity pools under the NAREIT or ASF letter need not have registered commodity pool operators or commodity trading advisors. Also, those entities may be eligible contract participants other than by virtue of being a commodity pool, they may be end-users that enjoy an exception from mandatory swap clearing and they may be funds that banking entities are not required to divest under the Volcker rule as proposed.

[In the CFTC letter related to persons designated as swap persons and ICE/NYMEX contract persons](#), CFTC provided temporary registration relief to certain persons. The relief covers introducing brokers (IBs), commodity pool operators (CPOs), commodity trading advisors (CTAs), floor brokers (FBs), floor traders (FTs) and their associated persons but not futures commission merchants (FCMs), though APs of FCMs are covered. The relief applies to the foregoing intermediaries and other persons only to the extent that they otherwise would be required to register solely by virtue of their involvement with swaps (i.e., where the requirement of a person to be so-registered “arises solely from the swap activity of such person”) or their involvement with the transition of certain contracts by ICE or NYMEX to clearing as commodity futures or options transactions. The relief generally is subject to the conditions that, on or before December 31, 2012, a person completes and files with the National Futures Association (NFA) the appropriate registration application and, after that date, the person makes a good faith effort to comply with the applicable requirements, as if the person were registered even if NFA has not declared the registration effective. Effectively, this particular CFTC letter will give CFTC until December 31, 2012 to evaluate the no-action requests submitted by mortgage and hybrid REITs, by ASF with respect to ABS/MBS not covered by the ASF no-action letter and by other potentially regulated parties, as well as to observe market developments.

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