MAYER|BROWN

CAPITAL MARKETS KNOW-HOW SERIES #19 & 20

REPACKAGINGS ARE BACK – PART 2 AND 3: SPECIFIC USE CASES AND SPECIFIC U.S. LAW CONSIDERATIONS

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AGENDA

1. Introduction to Repackagings (Part 1)
2. Typical Structures (Part 1)
3. Structural Aspects (Part 1)
4. Key Legal Considerations (Part 1 - continued)
5. Benefits and Risks of Repack Programmes (Part 2)
6. Specific Use Cases (Part 2)
7. Specific US Considerations (Part 3)

04

KEY LEGAL CONSIDERATIONS – PART 1 CONTINUED

CORE DOCUMENTATION (STAND ALONE)

- Notes documentation
- SPV domiciliation and administration agreement
- Arranger/Dealer Agreement (if a dealer is involved)
- Prospectus or Information Memorandum
- Issuance and Paying Agency Agreement / Trust Deed
- Asset Purchase Agreement or Asset Swap
- Hedging Documentation (if risk hedged)
- Custodian Documentation
- Security Documentation (Pledge / Deed of Charge / other)
- Collateral Agency/Security Trustee Agreement
- Collateral Administration/Management Agreement
- Enforcement/Selling Agent Agreement

CORE DOCUMENTATION (PROGRAMME – MODULAR STRUCTURE) (COMMON IN EUROPE)

- **Programme Agreement:**

  Programme Agreement can be based on a modular structure and with the following modules:

  - Conditions Module
  - Trust Module
  - Custody Module
  - Agency Module
  - Swaps Module.

- **Constituting Instrument/Issue Deed/Trust Instrument:**

  - Constituting Instrument (also sometimes called a Trust Instrument) will be issued on a per trade basis.
  - Constituting Instrument will make necessary trade specific amendments to the Modules, it will also set out he Issue Terms.

- **Advantages:**

  - Allows multiple SPVs in different jurisdictions to use the same documentation.
  - E.g. If a Bank establishes SPVs in Ireland, Luxembourg, Cayman and the Netherlands, it need only prepare an Information Memorandum for each SPV, together with a short from Programme Agreement, which incoprorates the same Modules. The Programme Agreement can also make any jurisdiction specific tweaks.

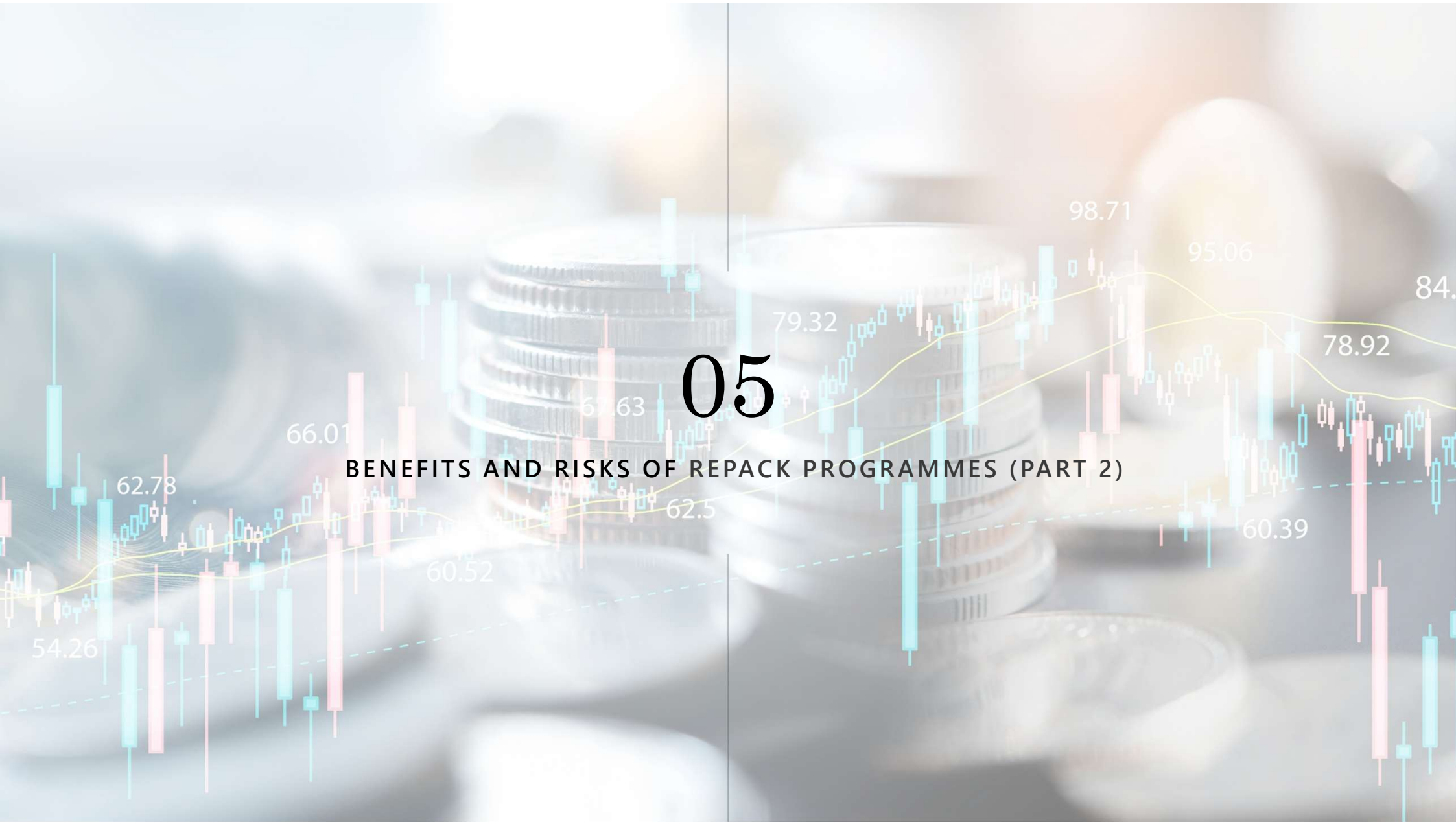
PROSPECTUS AND LISTING OBLIGATIONS

- Prospectus obligation in case of Public Offer of Securities (EU/UK)
- Prospectus obligation in case of Regulated Market Listings (EU/UK)
- Information Memorandum in case of qualified investor offerings only
- In case of an MTN listing, a prospectus obligation could apply, subject to the rules of the relevant market
- Additional contents of prospectuses in respect of the repackaging
  - Additional Risk factors
    - repack asset
    - hedging risk
    - in respect of the security interests/insolvency protection/aviodance risks
    - factors in connection with an enforcement
  - Additional descriptions on
    - repack asset
    - collateralisation structure and collateral agency/trustee functions
    - enforcement trigger, enforcement actions and use of enforcement proceeds
    - involved parties and legal arrangements

GOVERNING LAW SELECTION

- Free choice of law in respect of Notes documentation
  - Subject to local law market standards
- Usually free choice of law in respect of repack asset purchase or swaps
- Security Agreements are subject to the laws governing the creation of the collateral
- Governing law of Custody and Collateral Agency Agreements might depend on location of Custodian and their internal policies

→ Possible to apply multiple laws



05

BENEFITS AND RISKS OF REPACK PROGRAMMES (PART 2)

BENEFITS OF OF REPACK PROGRAMMES

Flexibility: Ability to issue a variety of note types, currencies, and maturities

Efficiency: Streamlined documentation and issuance process

Asset Access: Enables indirect access to specific repack assets for various reasons

Customisation: Repackaging structures can be structured to meet specific investor, legal or tax requirements

RISKS AND CHALLENGES OF REPACK PROGRAMMES

Complexity of structures

Dependence on performance of involved parties

Legal enforceability can be complex, especially with cross-border collateral, differing perfection rules, and the potential for claw-back in insolvency scenarios.

Operational complexity, dependency on custodian risks and risks in respect of the security trustee

Performance risks in respect of security trustee

Litigation risks in case investors challenge actions by trustees.

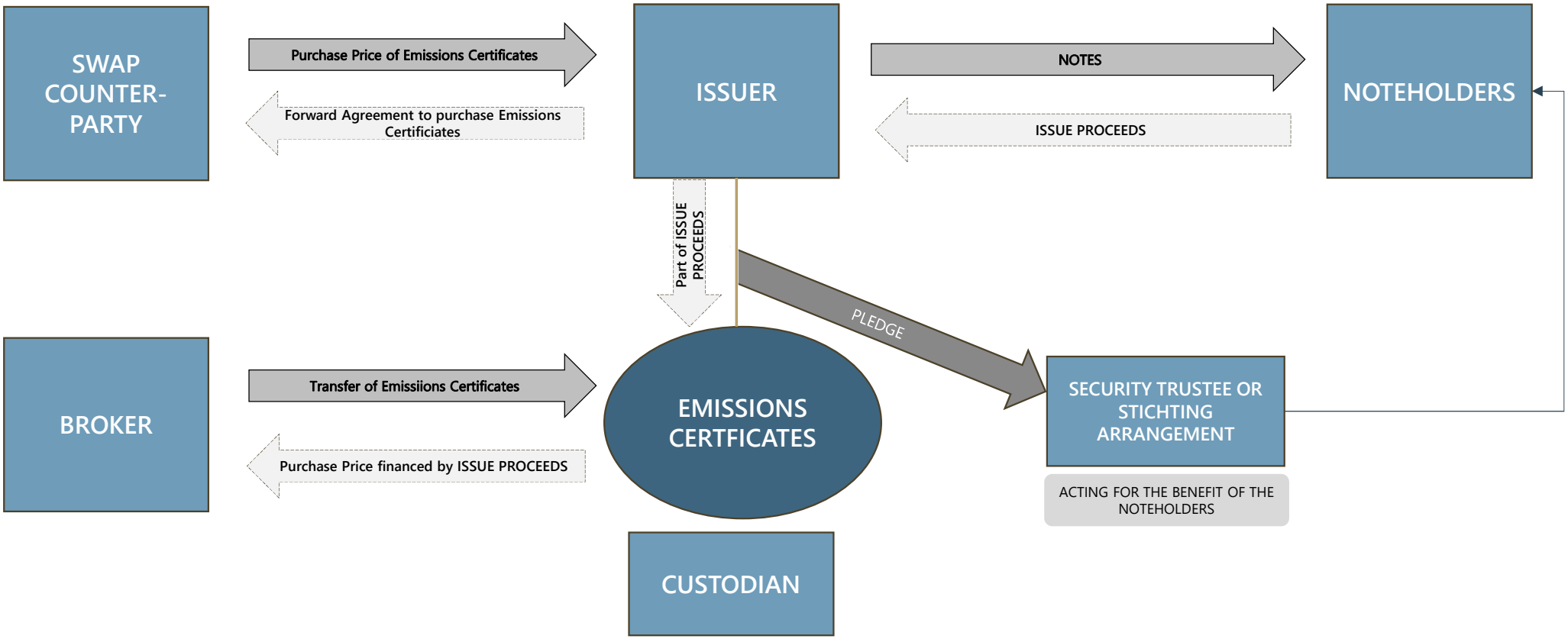
06

SPECIFIC USE CASES (PART 2)

SPECIFIC USE CASES FOR REPACKAGINGS

- Repackagings always serve a specific purpose for enabling an indirect exposure to the repackaging assets/stragegy
- Repackagings are highly flexible in terms of structuring
- Many use cases in the past and present, single and multi purpose repackagings, include:
  - Structured Notes repackaging transactions based on
    - principal protected structures using zero bonds (sometimes cover bonds) or other high quality financial instruments
    - asset swap and equity swap or total return swap repackagings with reduced counterparty risk structures via margin collateral arrangements
  - Commodity or Crypro Assets ETNs
  - Credit repacks, credit derivative product companies,
  - Untranched loan (portfolio) repackagings
  - SRTs; CRR risk mitigation instruments using SPVs
  - AMCs with active portolio management
  - Securities lending transactions as the basis for repackagings
  - Repackaging of EUAs and other crabon credits (see next slides)

REPACK STRUCTURE FOR EMISSIONS CERTIFICATES



BACKGROUND TO EMISSIONS TRADING: EMISSIONS TRADING – THE 3RD FLEXIBLE MECHANISM

- Emissions Trading: The Kyoto protocol's third flexible mechanism.
- It allows adhering Annex I parties and the public entities and private firms within them to trade allowance units with other Annex I parties and their public entities and private firms.
- The allowances may be units allocated under emissions trading schemes as well as certified emission reductions generated and
  nits
  rojects.

The EU emissions trading system (EU ETS) is a cornerstone of the EU's policy to combat climate change and its key tool for reducing greenhouse gas emissions cost-effectively. It is the world's first major carbon market and remains the biggest one.

The EU ETS:

- operates in all EU countries plus Iceland, Liechtenstein and Norway
- limits emissions from more than **11,000 heavy energy-using installations** (power stations & industrial plants) and **airlines** operating between these countries
- covers around **40%** of the EU's greenhouse gas emissions.

To achieve a climate-neutral EU by 2050 and the intermediate target of an at least 55% net reduction in greenhouse gas emissions by 2030, the Commission is proposing to revise and possibly expand the scope of the EU ETS. The Commission has published an inception impact assessment and launched an open public consultation on the revision of the system.

EU ETS: OVERVIEW

Sectors and gases covered

The system covers the following sectors and gases, focusing on emissions that can be measured, reported and verified with a high level of accuracy:

- **carbon dioxide (CO_2)** from
  - power and heat generation
  - energy-intensive industry sectors including oil refineries, steel works and production of iron, aluminium, metals, cement, lime, glass, ceramics, pulp, paper, cardboard, acids and bulk organic chemicals
  - commercial aviation
- **nitrous oxide (N_2O)** from production of nitric, adipic and glyoxylic acids and glyoxal
- **perfluorocarbons (PFCs)** from aluminium production

Participation in the EU ETS is **mandatory for companies in these sectors**, but

- in some sectors only plants above a certain size are included
- certain small installations can be excluded if governments put in place fiscal or other measures that will cut their emissions by an equivalent amount
- in the aviation sector, until 31 December 2023 the EU ETS will apply only to flights between airports located in the European Economic Area (EEA).

A 'cap and trade' system

The EU ETS works on the 'cap and trade' principle.

A cap is set on the total amount of certain greenhouse gases that can be emitted by installations covered by the system. The cap is reduced over time so that **total emissions fall**.

Within the cap, companies receive or buy **emission allowances**, which they can trade with one another as needed. They can also buy limited amounts of international credits from emission-saving projects around the world. The limit on the total number of allowances available ensures that they have a value.

After each year a company must surrender enough allowances to cover all its emissions, otherwise heavy fines are imposed. If a company reduces its emissions, it can keep the spare allowances to cover its future needs or else sell them to another company that is short of allowances.

Trading brings flexibility that ensures **emissions are cut where it costs least to do so**. A robust carbon price also promotes **investment in clean, low-carbon technologies**.

KEY EVOLUTIONS OF THE EU ETS

Phase II	Phase III	Phase IV	Fit for 55"
Lower cap on allowances (6.5% lower compared to 2005) The proportion of free allocation fell slightly to around 90% Several countries held auctions The penalty for non-compliance was increased to €100 per tonne Businesses were allowed to buy international credits (CERs / ERUs) totalling around 1.4 billion tonnes of CO2-equivalent Union registry replaced national registries and the European Union Transaction Log (EUTL) replaced the Community Independent Transaction Log (CITL) The aviation sector was brought into the EU ETS on 1 January 2012 (but application for flights to and from non-European countries was suspended)	Single, EU-wide cap on emissions in place of the previous system of national caps Auctioning as the default method for allocating allowances (instead of free allocation) Harmonised allocation rules applying to the allowances still given away for free More sectors and gases included 300 million allowances set aside in the New Entrants Reserve to fund the deployment of innovative, renewable energy technologies and carbon capture and storage through the NER 300 programme Auctioning of 900 million allowances postponed until 2019-2020. Market stability reserve starts in [2019]	Linking to Swiss ETS 0.46% increase of the linear reduction factor from 1.74 % to 2.2 %, which determines the amount by which the cap will decrease each year From 1 January 2021, the EU ETS covers the emissions from electricity generation in Northern Ireland, while the emissions from GB are no longer included Phase III and phase IV allowances to exist in parallel Phase IV allowances are not eligible for phase 3 compliance obligations Aviation allowances can be surrendered to meet the compliance obligations of aviation operators as well as stationary installations International credits, including certified emission reduction (CER) units that are generated from clean development mechanism (CDM) project activities under the Kyoto Protocol can no longer be used for compliance	Steeper annual emissions reduction of 4.2% Strengthened Market Stability Reserve Phase out of free allocation of allowances in sectors covered by the Carbon Border Adjustment Mechanism (CBAM) [see below] Allocation of free allowances to be linked to decarbonisation efforts Moving to full auctioning of allowances for aviation by 2027 Integrating the Global Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) scheme for international aviation Extension to emissions from maritime transport Parallel ETS for road transport and buildings from 2025, with compliance burden placed on fuel suppliers

UK ETS

- Post 01 January 2021, UK Emissions Trading System (UK ETS) replaced the UK's participation in the EU ETS.
- The new system applies to the power generation sector, aviation, and energy intensive industries.
- UK govt to consult on aligning system with net zero targets and explore expanding system to 2/3 of uncovered emissions.
- The system will continue to operate 'cap and trade' principle, however UK ETS will set a cap 5% lower than current EU ETS levels.
- Auctioned allowances to have fixed £15 minimum price. The UK govt open possibly linking UK ETS internationally.

Timetable for onboarding Registry accounts

From 6 April 2021

Users intending to request a UK ETS trading account will be able to register and sign in to use the service. Once registered, users can apply to open a UK ETS Trading Account.

If you want to participate in auctions from 19 May 2021, you must register with ICE Futures Europe to receive further detailed information on what to do next. Read further information about auctioning.

From 4 May 2021

Operators and Aircraft Operators participating in the UK ETS will be contacted by the Registry Administrator and asked to provide details of a primary contact (who is authorised to give instructions to the Registry Administrator on your behalf), and also to nominate authorised representatives to manage their Operator Holding Account (OHA) or Aircraft Operator Holding Account (AOHA).

UK Kyoto Protocol (KP) Person Holding Account holders in the EU Registry will have their accounts and units migrated to the UK Registry. These users will be contacted by the Registry Administrator and asked to provide details of a primary contact (who is authorised to give instructions to the Registry Administrator on your behalf), and also to nominate at least 2 authorised representatives to operate these migrated accounts for you.

From late May 2021

You will be able to apply to open a new UK KP Person Holding Account. The exact date will be confirmed at a later date.

A link to the UK Emissions Trading Registry will be made available here once it is open for registrations in April.

EUA REPACK NOTES: KEY ISSUES

- Which registry? Netherlands, Lux, Ireland? Can an SPV open an account.

- Can you take security over EUAs? In Netherlands you can't but in Luxembourg you can.

- Are EUAs, client assets under CASS Rules?

- Stichting structure allows creation of quasi-security.

- Concerns about position limits.

- Total return swaps on Structured Notes.

07

SPECIFIC US CONSIDERATIONS (PART 3)

07.1

KEY LEGAL CONSIDERATIONS

USING A TRUST

- A trust is a common vehicle for repackaging securities as well as accompanying derivatives or options. However, there are several structuring concerns associated with a trust vehicle
  - A trust usually is a passive vehicle (neither the trustee nor other parties actively manage the investment)
  - Often if there will be investors that are U.S. persons there is a concern that the trust will be an investment company under the Investment Company Act of 1940
- A Delaware master trust is often used
- While each series of the master trust will constitute a separate legal entity for most purposes and the assets of each series of the master trust generally will be segregated from the assets of each other series, there will still be some bankruptcy concerns
- The master trust would be established as a bankruptcy remote vehicle
- As a result, even for sales to U.S. investors, it is common to use a Cayman entity, Irish entity, a Luxembourg entity – because these forms of cell structures offer greater assurance regarding the separateness of the series

REPACKAGING VEHICLES

- Given the limitations of the SEC rules, the securities issued by most repack vehicles are offered on an exempt basis (4(a)(2), Rule 506, Rule 144A, or Reg S)
- For most structures to the extent the securities are offered and sold to U.S. persons, consideration should be given to:
  - 1940 Act and risk retention
  - Commodity pool considerations
  - Volcker Rule issues
  - Accounting consolidation

07.2

U.S. SECURITIES LAW CONSIDERATIONS

U.S. SECURITIES LAW CONSIDERATIONS

- "Super Regulation S" (Super Reg S)
  - Some repack programs are offered only outside the United States to non-U.S. persons with no possibility of flowback even after the distribution compliance period
  - The objective of the Super reg S approach is to avoid having to add the 1940 Act, CPO, CTA and related issues since there will be no U.S. jurisdictional nexus
- What if you have a Super Reg S program, can you "retrofit" it to allow for sales to U.S. persons?
- Yes, as we will discuss later for cell structures, the 40 Act analysis and the CPO analysis can be undertaken on a compartment basis generally

U.S. SECURITIES LAW CONSIDERATIONS (CONT'D)

- In practice, most programs will be set up to allow for Rule 144A/4(a)(2) sales for U.S. persons
  - Sales only to person reasonably believed to be QIBs
  - Disclosure generally is limited given the securities are sold to sophisticated investors
  - Repack vehicle must comply with "current information" requirement
  - U.S. paying agent and trustee (for DTC settlement), but indenture needn't be qualified under the Trust Indenture Act

07.3

1940 ACT CONSIDERATIONS

1940 ACT

- Why avoid investment company status?
  - If a trust is determined to be an investment company, it must register as such under the 1940 Act, which could subject the trust to numerous restrictions
    - Subject to regulatory scheme of the 1940 Act – reporting and other filing obligations
    - Limits on ability to transact with affiliates (sponsor/depositor may not be able to engage in business with the trust – for example, an affiliate that "underwrites" offerings of an investment company is subject to restrictions)
    - Restrictions on the issuance of debt
    - Must satisfy asset coverage test – 300% immediately following issuance of debt and 200% immediately following issuance of preferred securities
- An investment company is defined as an issuer that:
  - is or holds itself out as being engaged primarily in the business of investing, reinvesting or trading in securities;
  - is engaged in the business of issuing face-amount certificates of the installment type; or
  - is engaged in the business of investing, reinvesting, owning, holding or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40% of its assets

A NUMBER OF 1940 ACT EXEMPTIONS

- Some exemptions require limiting the number of investors:
  - For example, Section 3(c)(1) exempts from the definition of investment company any issuer whose outstanding securities are owned by not more than 100 persons and is not making a public offering
- Other exemptions limit ownership to certain classes of investors
  - For example, Section 3(c)(7) exempts from the definition of investment company any issuer whose securities are owned by "qualified purchasers" and is not making a public offering
- Asset-backed issuers are exempt from the 1940 Act pursuant to Rule 3a-7. Rule 3a-7 states:
  - Any issuer engaged in the business of purchasing, or otherwise acquiring and holding eligible assets and who does not issue redeemable securities will not be deemed an investment company
  - Redeemable securities are defined in Section 2(a)(32) as "any security other than short-term paper, under the terms of which the holder upon its presentation to the issuer (or someone designated by the issuer) is entitled to receive approximately his proportionate share of the issuer's current net assets, or the cash equivalent thereof

A NUMBER OF 1940 ACT EXEMPTIONS *(CONT'D)*

- Rule 3a-7 contains a number of conditions:
  - the issuer must issue fixed income securities or other securities that entitle their holders to receive payments that depend on the cash flow from eligible assets;
  - securities sold must be rated investment grade except for securities sold to qualified institutional buyers (QIBs) and institutional accredited investors;
  - acquisitions and dispositions of eligible assets may be made only in accordance with governing documents and may not trigger a downgrade in the issuer's rating; and
  - must appoint a non-affiliated trustee that has a perfected security interest in the assets

A NUMBER OF 1940 ACT EXEMPTIONS *(CONT'D)*

- The definition of "eligible assets" is similar to the assets specified in the definition of ABS under Reg AB II (referred to as Reg AB throughout for ease of reference)
  - Financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period, plus any rights or other assets designed to assure the distribution of proceeds
    - "Convert to cash" within a finite time period requirement may pose structuring challenges given certain types of assets
    - In repack structures, possible certain series may be backed by eligible assets (bonds, ABS, etc.) while other series will not be (equities, mutual fund shares)
    - To the extent that the entity qualifies for the Tule 3a-7 exemption, it will not be a "covered fund" for Volcker Rule purposes

CELL COMPANIES AND THE 1940 ACT

- In no-action letters issued by the Staff of the Division of Investment Management on other topics, the Staff has recognized that concept that series companies and Irish sub-funds should be treated as separate issuers—see for example Coutts Global Fund (Dec 7, 1994)
- Each sub-fund or compartment is a distinct legal entity

07.4

RISK RETENTION

RISK RETENTION

- Many repack vehicles are considered "securitizations" or involve the issuance of asset-backed securities to which the risk retention requirement would be applicable
- Depending upon the analysis, arguments may be made that certain series of the trust may not involve the issuance of asset-backed securities and, therefore, such series would not be subject to the risk retention requirement
  - Sometimes it may be reasonable to take the view that secured notes issued by a repack entity are not asset-backed securities (i.e., not collateralized by self-liquidating assets and payments not primarily dependent on cash flows from such assets). Secured notes benefit from collateral, and as a result, the risk retention requirements would not be applicable to a secured notes series
  - For repack notes, to the extent the assets consist of equities, mutual fund shares, or hedge fund shares, such repack notes would not be asset-backed securities (the underlying assets would not convert to cash within a finite period)
  - Other series of repack notes may constitute asset-backed securities (those having bonds as underlying assets for example).
  - To the extent notes of any series constitute asset-backed securities, the risk retention requirement generally would be applicable as to such series

RISK RETENTION *(CONT'D)*

- Under a 2016 C&DI, if the only asset held by the SPV is an obligation of the Sponsor, the SEC would look through the obligation held by the SPV to the balance sheet of the Sponsor when the payments on the notes replicate payments on the obligation and the obligation is a direct obligation of the Sponsor. In that case payments on the notes would be based solely on the ability of the Sponsor to make payments on the notes. The SEC would conclude that the notes are not "asset-backed securities."
- On the other hand, if the Sponsor is directly obligated on the notes through a guarantee of the notes or similar arrangement, the Sponsor would effectively be holding 100% of the credit risk of the issued notes.

RISK RETENTION REQUIREMENT

- Risk retention requirement:
  - The risk retention requirement applies to both public and private asset-backed securities because the rule applies to "asset-backed security" as defined in Section 3(a)(79) of the Securities Exchange Act.
  - For an issuance of asset-backed securities offered pursuant to an exemption such as Rule 144A, a risk retention requirement would apply. The 5% credit risk retention requirement was adopted as a result of the Dodd-Frank Act.
  - The required retained interest can be satisfied by holding either a "vertical interest" or an "eligible horizontal residual interest" or a combination of the two. A vertical interest would be the same percentage interest in each class of securities issued. An eligible horizontal residual interest would be the most subordinated class or classes representing the required percentage of the "fair value" of all ABS interests to be issued.
  - The retained interest must be held by the "sponsor" or a "majority-owned affiliate." A "majority-owned affiliate" is defined as an entity in which a person has ownership of more than 50% of the equity or ownership of any other controlling financial interest.

RISK RETENTION REQUIREMENT *(CONT'D)*

- Risk retention requirement:
  - The rule generally prohibits a sponsor from selling or otherwise transferring any retained interest other than to majority-owned or wholly owned affiliates of the sponsor. Moreover, a sponsor and its affiliates may not hedge their required risk retention positions or pledge those positions as collateral for any obligation (including a loan, repurchase agreement, or other financing transaction), unless the obligation is with full recourse to the pledging entity.
  - Certain hedging activities are not prohibited.

07.5

COMMODITY POOL ISSUES

COMMODITY POOL

- Dodd-Frank's inclusion of swaps as commodity interests means pooled investment vehicles trading in swaps (and their operators or advisors) must consider whether they may be subject to regulation as a commodity pool, a commodity pool operator or a commodity trading advisor
  - Holding or "trading" a single swap may render an entity a commodity pool
- As amended by Dodd-Frank, the Commodity Exchange Act ("CEA") defines the term "commodity pool" to include any investment trust, syndicate, or similar form of enterprise operated for the purpose of trading in commodity interests, including any—
  - (i) commodity for future delivery, security futures product, or swap;
  - (ii) agreement, contract, or transaction described in section 2(c)(2)(C)(i) of the CEA or section 2(c)(2)(D)(i) of the CEA;
  - (iii) commodity option authorized under section 6c of the CEA; or
  - (iv) leverage transaction authorized under section 23 of the CEA

COMMODITY POOL DEFINITION

- In addition, the CFTC, by rule or regulation, may include within, or exclude from, the term “commodity pool” any investment trust, syndicate, or similar form of enterprise if the CFTC determines that the rule or regulation will effectuate the purposes of the CEA

COMMODITY POOL OPERATOR DEFINITION

- As amended by Dodd-Frank, the CEA now defines the term "commodity pool operator" to include any person:
  - I. engaged in a business that is of the nature of a commodity pool, investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in commodity interests, including any—
    - i. commodity for future delivery, security futures product, or swap;
    - ii. agreement, contract, or transaction described in section 2(c)(2)(C)(i) of the CEA or section 2(c)(2)(D)(i) of the CEA;
    - iii. commodity option authorized under section 6c of the CEA; or
    - iv. leverage transaction authorized under section 23 of the CEA; or
  - II. who is registered with the CFTC as a commodity pool operator
- In addition, the CFTC has authority to include within, or exclude from, the CPO definition any person if such inclusion or exclusion will effectuate the purposes of the CEA

COMMODITY TRADING ADVISOR DEFINITION

- As amended by Dodd-Frank, the CEA now defines the term "commodity trading advisor" to include any person who:
  - I. for compensation or profit, engages in the business of advising others, either directly or through publications, writings, or electronic media, as to the value of or the advisability of trading in—
    - i. any contract of sale of a commodity for future delivery, security futures product, or swap;
    - ii. any agreement, contract, or transaction described in section 2(c)(2)(C)(i) of the CEA or section 2(c)(2)(D)(i) of the CEA;
    - iii. any commodity option authorized under section 6c of the CEA; or
    - iv. any leverage transaction authorized under section 23 of the CEA;
  - II. for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the activities referred to in clause (i)
  - III. is registered with the CFTC as a commodity trading advisor; or
  - IV. the CFTC, by rule or regulation, may include if the CFTC determines that the rule or regulation will effectuate the purposes of the CEA

COMMODITY TRADING ADVISOR DEFINITION *(CONT'D)*

- The CTA definition specifically excludes the following if the commodity advice is "solely incidental to the conduct of their business or profession":
    - i. any bank or trust company or any person acting as an employee thereof;
    - ii. any news reporter, news columnist, or news editor of the print or electronic media, or any lawyer, accountant, or teacher;
    - iii. any floor broker or futures commission merchant;
    - iv. the publisher or producer of any print or electronic data of general and regular dissemination, including its employees;
    - v. the fiduciary of any defined benefit plan that is subject to the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1001 et seq.);
    - vi. any contract market or derivatives transaction execution facility; and
    - vii. such other persons not within the intent of this paragraph as the CFTC may specify by rule, regulation, or order

CERTAIN CPO REGISTRATION EXEMPTIONS BY RULE

- CFTC Rule 4.13(a)(3) provides a commodity pool-level exemption for a CPO where the pool trades a *de minimis* amount of commodity interests (*e.g.*, swaps, options or futures)
- For a pool to claim the exemption, the following requirements must be met:
  - Interests in the pool are exempt from registration under the Securities Act of 1933, and such interests are offered and sold without marketing to the public in the United States
  - The pool, at all times, meets one of the following two tests with respect to all of its commodity interest positions:
    - The aggregate initial margin, premiums, and required minimum security deposit for commodity interest transactions does not exceed 5% of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions (the "5% Test"); *or*
    - The aggregate net notional value of such positions does not exceed 100% of the liquidation value of the pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions (the "Liquidation Test")

THE 4.13(A)(3) EXEMPTION

- The operator reasonably believes, at the time of investment, that each person who participates in the pool is:
  - An accredited investor;
  - A trust formed by an accredited investor for the benefit of a family member;
  - A knowledgeable employee; *or*
  - A qualified eligible person
- Investments in the pool are not marketed as a vehicle for trading in or generating exposure from the commodity interest markets
- Subject to limited exceptions, neither the operator nor any of its principals is subject to a statutory disqualification that would require disclosure under CEA §8a(2) if such person sought registration
- The exemption is claimed by operators on a fund-by-fund basis via an electronic notice filing with the NFA

CPO RULEMAKINGS

- **Over time, the CFTC has amended the rules relating to CPOs generally in order to provide relief to market participants**
- **Rule 3.10(c)(5) Amendments**
  - Pool-by-Pool Exemptions
    - A non-US CPO may rely on the exemptive relief even if it serves as a CPO to other pools in which US persons are invested
  - Permitted Seed Investments by US Affiliates
    - Initial capital contributions to a pool made by a US affiliate of a non-US CPO may be disregarded in determining whether participation in that pool is limited to only foreign located persons
  - Safe Harbor
    - A non-US CPO that satisfies several conditions, which focus on non-US persons and activities, may rely on a safe harbor

CPO THRESHOLD QUESTIONS

- Consider whether the repack vehicle trades or holds “commodity interests”
- Consider whether securities of the vehicle will be sold to U.S. persons.
- Who holds the ownership interests in the vehicle and is there a “pooling” of interests?
- If there potentially may be a commodity pool, is it beneficial to consider on a cell by cell (pool by pool) basis? Or is the de minimis exemption workable?

07.6

VOLCKER RULE

COVERED FUND ISSUES

- A banking entity (including Sponsor and any affiliate), as principal, may not directly or indirectly acquire or retain an ownership interest in, or sponsor, a covered fund
- A covered fund is defined to include a fund that relies solely on the Section 3(c)(1) or 3(c)(7) exemptions. A fund that can rely on Section 3(c)(1) or 3(c)(7) will not be a covered fund if another 1940 Act exemption is available to it, such as Rule 3a-7
- If the issuer relied on Section 3(c)(1) or 3(c)(7) of the 1940 Act and another 1940 Act exemption is not available, it may still avail itself of one or more of the enumerated exclusions from the definition of covered fund

EXCLUSIONS FROM COVERED FUND DEFINITION

- Of these exclusions, four are most likely to be applicable to a repack issuer:
  - X Loan securitization exclusion
  - X Qualifying asset-backed commercial paper (ABCP) conduit exclusion
  - X Qualifying covered bond exclusion
  - Wholly-owned subsidiary exclusion

WHOLLY OWNED SUBSIDIARY EXCLUSION

- This exclusion applies to an entity if all its outstanding ownership interests are owned directly or indirectly by a banking entity or an affiliate thereof, except that:
  - up to five percent of the entity's ownership interests may be owned by directors, employees, and certain former directors and employees of the banking entity or its affiliates; and
  - within the five percent ownership interest, up to 0.5 percent of the entity's outstanding ownership interests may be held by a third party if the ownership interest is held by the third party for the purpose of establishing corporate separateness or addressing bankruptcy or insolvency
- This exclusion helped clarify that wholly owned "depositors" and other intermediate transferors of assets in a securitization are not considered covered funds
- A wholly owned subsidiary of the Sponsor would be a subsidiary for purposes of the Bank Holding Company Act and a banking entity for purposes of the Volcker Rule

COVERED FUND RESTRICTIONS

- If an issuer is determined to be a covered fund, banking entities are prohibited from:
  - acquiring "ownership interests" in the securitization issuer,
  - sponsoring the securitization issuer, and
  - making loans to, or entering into certain other types of transactions with a securitization issuer for which the banking entity acts as sponsor, investment manager, investment adviser or commodity trading advisor
- Prohibitions described in the third bullet point above are defined in the Final Rule by reference to the restrictions of Section 23A of the Federal Reserve Act, and are commonly referred to as the "Super 23A" provisions. These restrictions, among other things, severely limit the ability of banking entities to provide credit and liquidity support to covered fund securitizations to which they are related as investors, sponsors or advisors
- Additionally, permitted transactions between the banking entity and the securitization issuer must be on market terms

DEFINITION OF "OWNERSHIP INTEREST"

- An ownership interest includes any equity or partnership interest in a covered fund or any other interest in or security issued by a covered fund that exhibits any of certain characteristics on a current, future or contingent basis, including:
  - has the right to participate in the selection or removal of a general partner, managing member, member of the board of directors, investment manager, investment adviser or commodity trading advisor (not including rights of a creditor to exercise remedies in the event of a default);
  - has the right under the terms of the interest to receive a share of the income, gains, or profits of the covered fund (regardless of whether the right is pro rata with other owners);
  - has the right to receive underlying assets of the covered fund, after all other interests have been redeemed and/or paid in full (the "residual" in securitizations);
  - has the right to receive all or a portion of excess spread;
  - provides that the amounts payable by the covered fund with respect to the interest could, under the terms of the interest, be reduced based on losses arising from the underlying assets of the covered fund, such as allocation of losses, write-downs or charge-offs of the outstanding principal balance, or reductions in the amount of interest due and payable on the interest;
  - receives income on a pass-through basis from the covered fund, or has a rate of return determined by reference to the performance of the underlying assets of the covered fund (excluding interests that are entitled to received dividend amounts calculated at a fixed or floating rate); and
  - any synthetic right to have, receive or be allocated any of the rights described above (which would not allow banking entities to obtain derivative exposure to these characteristics)

DEFINITION OF "SPONSOR"

- The Final Rule defines "sponsor" to mean any entity that:
  - **serves as general partner, managing member, or trustee of a covered fund, or that serves as a commodity pool operator of a covered fund,**
  - selects or controls (or has employees, officers, or directors, or agents who constitute) a majority of the directors, trustees, or management of a covered fund, or
  - shares with a covered fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name

ACCOUNTING CONSIDERATIONS

- The objective of avoiding consolidation may be achieved by a vehicle established as an "orphan," with the equity interest held by a third party
- Even assuming that the vehicle were set up in such manner, a de-consolidation analysis may be made more challenging if the Sponsor has a role as a swap counterparty and/or as a guarantor of sorts by substituting collateral and providing financing

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The team consists of experienced lawyers as well as young, ambitious and inquisitive talents. This also makes it clear to the clients how important it is to the partners to provide well founded training for the up and coming talent. In addition, all team members are incredibly friendly, so working together is a lot of fun, even beyond the technical side.

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