Forex CTA/CPO Fund

Forex or FX or retail off-exchange foreign currency transactions all refer to the same thing – trading foreign currencies for gain, usually in the spot market.
The Forex markets have grown tremendously over the last few years and both individual investors and money managers are trading foreign currencies to make money. There are many reasons why managers have decided to trade the forex markets including the following:
(1) the forex markets are the most liquid markets in the world;
(2) the forex markets trade twenty four hours a day, six days of the week;
(3) managers have access to a large amount of leverage (sometimes up to 400:1); and
(4) there has been relatively little oversight and regulation of the forex markets at the federal or state levels.
Regulations
For those managers which will be managing forex hedge funds, the disclosure document requirements are in addition to the requirements imposed by other securities laws (please see hedge fund offering documents or a more detailed explanation of the forex hedge fund offering document requirements).
Recently passed regulations require introducing brokers and forex commodity trading advisors (CTA), forex hedge fund managers (also known as commodity pool operators "CPO") whose business involves retail off-exchange foreign exchange (forex) contracts need to be NFA members and register with the CFTC. These new categories of registered persons, as provided by the NFA, are called "Forex CPOs" and "Forex CTAs." Like the CPO and CTA disclosure documents, it is likely that both Forex CPOs and Forex CTAs will be required to deliver a disclosure document to prospective investors. The Forex CPO or Forex CTA will need to make delivery at the same time or before the delivery of the Forex Pool's offering documents or the Forex Program's advisory agreement. The Forex CPO or CTA will need to receive signed acknowledgement by the investor that they have received the disclosure document.
Forex managers will to provide a forex fund disclosure documents (which include a private placement memorandum, a limited partnership agreement and various subscription documents for investors). Managers will also be required to sit for and pass the Series 3 and Series 34.
The costs involved with process include legal fees and NFA registration fees. The fees include the following:
* $200 for the firm registration
* $85 for each associated person of the firm (there must be at least one)
* $750 NFA Membership (which is due on an annual basis)
In addition to these costs the manager must be aware about other fees like entity formation fees and blue sky filing fees.
Managers must also be aware that there are forex examination requirements. Specifically, all associated persons will need to have a Series 3 exam license

(generally for futures trading) and a new Series 34 exam license (for forex only managers).
Basics of a Forex Disclosure Document
Cover Page. The Forex Disclosure Document will probably need to have a CFTC mandated disclaimer which basically states that the CFTC has not reviewed the disclosure document for the merits of the trading program.
Front Cover Disclaimer. Inside the front cover the Forex disclosure document there will need to be a few paragraphs that serve as a general disclaimer of risk disclosure statement. This disclaimer will be based on a uniform template for all Forex disclosure documents.
Table of Contents. A basic table of contents will be required.
Basic Background Information. The beginning part of the document will need to include such basic information as name of the Forex CPO or CTA, addresses, phone numbers, etc. The business background of each principal (each a "Forex Associated Person" or "Forex AP") as well as the officers and directors of the firm will need to be provided. The information each of the people will need to provide includes: date of NFA membership, date of CFTC registration, and dates of employment for last five years.
Forex Dealer Member. For Forex CTAs, if the program requires an investor to maintain an account with a Forex Dealer Member ("FDM") then the name of the FDM must be disclosed. For Forex CPOs, the document should disclose who will be the fund's FDM.
Forex Introducing Brokers. For Forex CTAs, if the program requires an investor to have an account introduced by aForex Introducing Broker ("Forex IB"), then the name of the Forex IB must be disclosed.
Principal Forex Risk Factors. For both Forex CPOs and Forex CTAs the document must include a discussion of the main risks involved in the Forex program. Such risks are expected to include: country or sovereign risk, credit risk, exchange rate risk, interest rate risk, liquidity risk, market risk, operational risk, settlement risk and Herstaat risk. In addition, for Forex CPOs, there are other risks involved in the structure of the investment vehicle which will need to be disclosed.
Forex Trading Program. All aspects of the proposed trading program must be disclosed and discussed. A Forextrading program will usually include information on the investment object and the investment strategies as well as a discussion of the risk management procedures the Forex manager will utilize. This area of the program may also discuss the Forex manager's investment philosophy. Forex Fees. All aspects of the fee structure of the Forex hedge fund or Forex separately managed account must be discussed. This will include both management fees and performance fees (if applicable) as well as the methods for calculating the fees. The rules require specificity here so this will be one area where precise information is required.
Conflicts of Interest. This will be very important information and the Forex manager will want to discuss this section thoroughly with its attorney or compliance professional. All actual or potential conflicts of interest must be disclosed. All fee and business arrangements must be disclosed. For example, if

the forex manager will have any sort of pip sharing arrangement with the Forex Dealer Member, this will need to be disclosed.

Litigation. If any of the persons or entities involved in the trading program have been subject to "material administrative, civil or criminal" actions within the past five years, all information regarding the action must be disclosed. Disclosure is required for the Forex CTA, Forex CPO, Forex IB, Forex Dealer Member or FCM, and any principles of the Forex CPO or CTA. Oftentimes the FCM (with regard to CPO and CTA disclosure documents) must disclose a lengthy list of actions.

Trading Forex for Own Account. The disclosure document must disclose whether the Forex manager and/or any employees will be trading for their own accounts. If the Forex manager and/or any employees will be trading for their own accounts then the document must disclose whether the manager or employees will allow investors to review the trading records of the manager or employees.

Performance Reporting

Basically the performance reporting aspect of the disclosure documents requires the manager to provide very detailed summaries of the performance of the offered program (either managed account or fund), the manager's other trading programs, and potentially the performance of key employees. Any other performance which is material will also need to be reported. These performance disclosures will usually take up a few pages of the disclosure document and will face the greatest scrutiny by the NFA reviewers. If the has been no prior performance history of the offered program or by the manager, then there are specific disclaimers which will need to be provided. One of the outstanding questions which we assume will be answered in the coming weeks and months is to what extent a forex manager will need to provide performance reporting from other programs which do not relate to forex (for example, securities or managed futures). Because the characteristics of other investment instruments often differ greatly from off-exchange foreign currency transactions, I am not sure it would be helpful to require such information to be included in the forex disclosure document.

Additional Information Required for Forex CPOS

Because there are structural differences between a forex hedge fund and a forex separately managed account, there are additional disclosure items for a forex hedge fund. Some of the items that the Forex CPO is going to have to provide is information on the forex hedge fund's breakeven point (the return needed to break even given the fund's management fees and other fees and expenses including the amortization of legal costs, if applicable), ownership of the forex hedge fund, and when the fund will provide reports to investors in the fund.

Material Information

The forex manager will need to disclose all information that is material to an investment in the program. All such information must be disclosed in the document even if it is not required by the CFTC rules.

Supplemental Information

The forex manager may include supplemental information (i.e. information not required by the CFTC rules, the CEA, or other federal or state laws) in the disclosure document. However, the forex manager should note that such supplemental information is subject to the same requirements as the other information in the disclosure document and may not be misleading or inconsistent. Generally all supplemental information must be presented after the main disclosure required by the CFTC – this can be accomplished through a separate supplemental information document called the “Statement of Additional Information,” or at the end of the forex disclosure document.

Contact us for more information