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CFTC Update

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CFTC Amends Requirements for CPO Financial Reports

Amedments Adopted

The Commodity Futures Trading Commission (CFTC) adopted amendments, which became effective on December 27, 2016, to its regulations for financial reports required to be filed by commodity pool operators (CPO) with respect to the pools that they operate.[1] These amendments (1) permit greater use of accounting standards *other than* United States generally accepted accounting principles (US GAAP), and (2) provide relief from audit requirements where pools have been operating for a short period of time or the participants are insiders. If the CPO of the pool is also registered as an investment adviser under the Investment Advisers Act of 1940, as amended (Advisers Act), however, it should also consider whether compliance with the custody rule (Rule 206(4)-2 under the Advisers Act) would nevertheless require the preparation and distribution of audited financial statements in accordance with U.S. GAAP.

International Accounting Standards

Historically, commodity pool financial statements were required to be presented in accordance with US GAAP. About seven years ago, the CFTC permitted CPOs to use International Financial Reporting Standards (IFRS) in financial reports for pools organized under non-US law, subject to certain conditions. The CFTC has now amended its regulations to permit a CPO to use generally accepted accounting principles followed in the United Kingdom, Ireland, Luxembourg, or Canada, subject to the same conditions for using IFRS. A CPO who wants to use other than US GAAP in a report must also file a notice with the National Futures Association (NFA) identifying itself, the pool for which relief is claimed and the alternative accounting principles being used, as well as representing that it will abide by the conditions applicable to using alternative accounting principles.[2] These alternative accounting principles may be used in annual reports, periodic financial reports, and Form CPO-PQR (Quarterly Report for Commodity Pool Operators). The CFTC adopted an amendment to Form CPO-PQR in response to comments on its proposed amendments and stated that this amendment overrides the instructions to that form.[3]

Exemption from Audited Annual Report Requirement

The CFTC adopted an exemption from the audit requirement for the annual report for a pool's first fiscal year if the period from formation of the pool (which is defined as the date the CPO first receives funds, securities, or other property for the purchase of an interest in the pool) to the end of the pool's first fiscal year is four months or fewer, which is referred to as the "stub" period. This exemption is subject to the conditions that, during the stub period, the pool has no more than 15 "non-insider" participants, and total gross capital contributions to the pool do not exceed $3 million.[4] In addition, the CPO must obtain a written waiver of the right to receive an annual report from each participant *other than* the CPO; a CTA to the pool; any person controlling, controlled by, or under common control with, the CPO or CTA; and any principal of the foregoing.[5] The waiver may be included in the subscription agreement for the pool or other agreement with the participant if (1) the waiver is a separate page in the agreement, and (2) the CPO requires the participant to separately sign and date it. Further, the CPO must file a notice with NFA claiming the relief and certifying that it has received the specified waivers.

CPOs claiming this relief would still be required to prepare and distribute an *unaudited* annual report for the stub period, the cover page of which must prominently include a statement that it only covers the stub period. Further, the next annual report for the pool must prominently disclose on the cover page thereof that it covers the stub period plus the following 12-month fiscal year.

The CFTC amendments also provide an exemption from the annual audited report requirement for any year during which the pool participants are limited to the CPO; a CTA to the pool; any person controlling, controlled by, or under common control with the CPO or CTA; and any principal of the foregoing. This relief also requires a waiver by those participants, but no notice to the NFA is required.[6]

The CFTC seeks to ensure that an audit is conducted at least once for each pool operated by a registered CPO. Consequently, if the CPO took advantage of the relief provided for the stub period and liquidated the pool before the end of the following full fiscal year, an audited final report would be required and the ability to claim exemption in accordance with CFTC Regulation 4.22(c)(7)(iii) would be unavailable. Likewise, even if the pool's sole participants are limited to the CPO; a CTA to the pool; any person controlling, controlled by, or under common control with the CPO or CTA; and any principal of the foregoing, the CPO must distribute an audited annual report at least once during the life of the pool.

Additional Relief?

The CFTC stated when it announced the adoption of these amendments that, although CPOs may continue to request exemptive relief from financial reporting requirements from the Staff, the CFTC intends that Staff restrict any further relief to exceptional circumstances involving unique situations. The Staff did indicate to the authors, however, that prior no-action relief from the audit requirements previously granted by the Staff should remain in effect.

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NOTES

1 81 Fed. Reg. 85147 (November 25, 2016).

2 These conditions include: (1) the annual report must include a schedule of investments (condensed, unless a full schedule is required under the alternative accounting principles); (2) any special allocations of ownership equity must be reported in accordance with CFTC Regulation 4.22(e)(2); (3) the pool's Disclosure Document or offering memorandum must identify the accounting principles being used; and (4) in the event that the alternative accounting standards require consolidated financial statements for the pool (*e.g.,* in a master-feeder fund structure), all applicable disclosures required by US GAAP must be provided.

3 81 Fed. Reg. 85147, at 85149 & n.13.

4 Insiders include the CPO; any commodity trading advisor (CTA) to the pool; any person controlling, controlled by, or under common control with the

CPO or CTA; and any principal of the foregoing, as well as certain relatives of the foregoing persons or entities wholly owned by such persons. Gross capital contributions include all capital contributed to the pool, notwithstanding any subsequent withdrawals.

5 Accordingly, although the CPO's spouse would not count against the limit on the number of participants and the spouse's contributions would not be counted against the limit on the amount of capital contributions, that spouse would nevertheless need to waive receipt of an audited annual report.

6 However, the CPO must maintain such waivers as part of its recordkeeping requirements and make them available upon request to the CFTC or NFA.