

Client Update

CFTC Adopts Amendments Regarding CPO Reports

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The Commodity Futures Trading Commission (“CFTC”) recently adopted amendments¹ to certain of its regulations governing annual report (“Annual Report”), periodic account statement and CPO-PQR filing requirements for registered commodity pool operators (“CPOs”). The proposed amendments generally codify certain exemptive relief that the CFTC staff has provided on a case-by-case basis in recent years. The amendments are based on proposals published by the CFTC earlier this year,² with some modifications and additions.

The amendments take effect on December 27, 2016 and, when considered alongside existing regulations, will generally permit CPOs (if certain conditions are met) to:

- use specified non-U.S. accounting principles for financial statements in Annual Reports and other periodic financial statements, and when reporting financial information on Form CPO-PQR; and
- forego audit requirements for Annual Reports for (1) the initial stub period of a commodity pool (if such stub period is four months or less), (2) the final fiscal year of a commodity pool that ceased operations during or at the end of such fiscal year and (3) periods during which the only participants in a commodity pool are the CPO itself or certain other insiders, subject in each case to obtaining waivers from relevant pool participants and to the requirement that an audit is conducted at least once in the life of any commodity pool.

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

² 81 Fed. Reg. 51828 (August 5, 2016).

CPO ANNUAL REPORT, PERIODIC ACCOUNT STATEMENT AND FORM CPO-PQR REQUIREMENTS GENERALLY

Pursuant to CFTC Regulation 4.22, registered CPOs are generally required to distribute to pool participants, and to submit to the National Futures Association (“NFA”), an Annual Report for each registered pool following the end of the pool’s fiscal year and certain other periodic account statements. The regulation, among other matters, specifies the financial statements and related information that the Annual Report must contain (CFTC Regulation 4.22(c)) and requires that the financial statements must be presented and computed in accordance with generally accepted accounting principles consistently applied (U.S. GAAP) (or, if certain conditions are met, International Financial Reporting Standards (IFRS)) and audited by an independent public accountant (CFTC Regulation 4.22(d)).

CFTC Regulation 4.7(b)(2) requires that a CPO claiming the relief under Regulation 4.7 for a partially exempt pool use U.S. GAAP (or, if it has elected to use IFRS for its Annual Report, IFRS) in presenting and computing periodic statements.

All registered CPOs are also required to file Form CPO-PQR with the NFA on a periodic basis. CFTC Regulation 4.27(c)(2) and the Instructions to Form CPO-PQR provide that all financial statements included in Form CPO-PQR must be presented and computed in accordance with U.S. GAAP consistently applied.

AMENDMENTS ON USE OF ALTERNATIVE ACCOUNTING STANDARD

Annual Reports and Other Periodic Account Statements

CFTC Regulation 4.22(d) requires that financial statements contained in an Annual Report be presented and computed in accordance with U.S. GAAP or, if certain conditions are met, IFRS.

Amended CFTC Regulation 4.22(d)(2) will permit the use of generally accepted accounting principles, standards or practices followed in the United Kingdom, Ireland, Luxembourg or Canada, as well as IFRS (each, an “Additional Alternative Standard”), if the relevant pool is organized under the laws of a jurisdiction other than the United States and the relevant Additional Alternative Standard is followed in such other jurisdiction. A CPO desiring to use a permitted Additional Alternative Standard is required to claim the relief by filing a notice with the NFA containing certain representations. These generally include representations that:

- The jurisdiction in which the pool is organized follows one of the permitted Additional Alternative Standards, and the pool's financial statements are presented in accordance with such Additional Alternative Standard.
- The Annual Report includes a schedule of investments (condensed unless a full schedule is required under the applicable accounting principles, standards or practices).
- Any special allocations of ownership equity are reported in accordance with CFTC Regulation 4.22(e)(2).
- The Disclosure Document or offering memorandum for the pool identifies the Additional Alternative Standard employed by the pool.
- In the event that the relevant Additional Alternative Standard requires consolidated financial statements for the pool (e.g., such as a feeder fund consolidating with its master fund), all applicable disclosures required by U.S. GAAP for the feeder fund have been provided.

A conforming amendment to CFTC Regulation 4.22(a) will permit the use of the same Additional Alternative Standard for periodic account statements prepared and distributed by a CPO for a pool if the CPO has satisfied the conditions for using that Additional Alternative Standard for the Annual Report for such pool.

Partially Exempt Pools under CFTC Regulation 4.7

After taking into account a conforming amendment to CFTC Regulation 4.7(b)(2), the CPO of a partially exempt pool under CFTC Regulation 4.7 will be permitted to use an Additional Alternative Standard for Annual Reports and periodic financial statements for such pool if the pool meets the conditions under CFTC Regulation 4.22(d) for the use of such Additional Alternative Standard, including the filing of the specified notice with the NFA.

Form CPO-PQR

A conforming amendment to CFTC Regulation 4.27(c)(2) provides that a CPO who has elected to use an Alternative Additional Standard for its pool's Annual Report may also use that Alternative Additional Standard in reporting financial information on Form CPO-PQR.

AMENDMENTS ON EXCEPTIONS FROM AUDIT REQUIREMENT

Initial Stub Periods

CFTC Regulation 4.22(g) governs the election of a fiscal year for a pool by its CPO. Among other things, it permits the CPO initially to elect any fiscal year for

a pool, provided that the pool's first fiscal year does not end more than one year after the pool's formation (CFTC Regulation 4.22(g)(1)).

The interaction of CFTC Regulation 4.22(g) with CFTC Regulations 4.22(c) and 4.22(d) can be unduly burdensome in certain circumstances. For example, the CPO of a pool that was formed two months before the end of its first fiscal year would be required to deliver an audited Annual Report for that two-month fiscal year even where there are a limited number of participants in the pool and a limited amount of funds have been contributed to the pool.

Amended CFTC Regulation 4.22(g)(2) will provide for an exemption from the Annual Report audit requirement for a pool's first fiscal year when the period from the pool's first receipt of funds, securities or other property from non-insiders³ to the end of the pool's first fiscal year (the "Stub Period") is a short period of time.

More specifically, subject to complying with other specified procedures, a CPO could claim this relief where:

- the Stub Period is four months or less,
- throughout the Stub Period, the pool had no more than 15 participants and no more than \$3,000,000 in aggregate gross capital contributions,⁴ and
- the next Annual Report is audited and covers the Stub Period plus the pool's first twelve-month fiscal year.

A CPO desiring to avail itself of this relief is required to obtain, prior to the date on which the Annual Report for the pool's first fiscal year is due, a specified written waiver of the right to receive an audited Annual Report for that fiscal year from each person who has been a participant in the pool during the first fiscal year (other than the pool's CPO, the pool's commodity trading advisor ("CTA"), any person controlling, controlled by or under common control with

³ Pursuant to CFTC Regulation 4.22(g)(2)(ii), insiders for this purpose include: (1) CPO-Related Insiders; (2) a child, sibling or parent of a CPO-Related Insider; (3) the spouse of any of the participants described in categories (1) or (2); (4) any relative of one of the participants described in categories (1) through (3), their spouse or a relative of their spouse, who has the same principal residence as such participant; and (5) an entity that is wholly owned by one or more of the participants described in categories (1) through (4) (collectively, "Pool Insiders").

⁴ For the purpose of determining eligibility for the relief, Pool Insiders and their capital contributions may be excluded.

the CPO or CTA, and any principal of the foregoing (collectively, “CPO-Related Insiders”).⁵

Then, on or before the date on which the Annual Report for the pool’s first fiscal year is due, the CPO must file a notice of claim with the NFA, along with a certification that the CPO received the specified written waiver from each of the pool’s relevant participants.

Finally, the CPO must include (i) on the cover page of an Annual Report for a pool for which relief has been claimed under CFTC Regulation 4.22(g)(2)(ii), a prescribed statement indicating that such Annual Report is unaudited and covers the specified Stub Period, and (ii) on the cover page of the next Annual Report for such a pool, a prescribed statement indicating that such Annual Report is audited and covers the period running run from the beginning of the Stub Period to the end of the pool’s first twelve-month fiscal year.

The CFTC notes that the staff intends to restrict the issuance of future case-by-case relief in respect of the amended standards on stub periods to exceptional circumstances involving unique situations.

Cessation of Operations and Final Fiscal Year

CFTC Regulation 4.22(c)(7) makes available various exceptions to Annual Report requirements to the CPO of a pool that ceases operation prior to, or at the end of, the pool’s fiscal year. In particular, paragraph (c)(7)(iii) provides that a report distributed and submitted pursuant to CFTC Regulation 4.22(c)(7) is not required to be audited if the CPO complies with certain conditions stated in that regulation, including obtaining specified written waivers from all pool participants.

To ensure that an audit is conducted at least once in the life of a commodity pool, the CFTC has amended CFTC Regulation 4.22(c)(7)(iii) to make relief thereunder unavailable where a CPO has not previously distributed an audited Annual Report to pool participants or submitted the audited Annual Report to the NFA. This would, for example, cover a scenario where the CPO has claimed relief from the Annual Report audit requirement for a pool’s first fiscal year

⁵ The waiver may be included in the subscription agreement for the pool or another agreement with the participant, provided that it must be a separate page in the agreement and must be separately signed and dated by the participant.

pursuant to CFTC Regulation 4.22(g)(2)(ii), as described above, and the pool has ceased operations before the end of its first twelve-month fiscal year.⁶

Insider Pools

Amended CFTC Regulation 4.22(d)(1) will exclude from the Annual Report audit requirement any Annual Report for a fiscal year during which the only participants in the pool are one or more CPO-Related Insiders. A CPO relying on such exclusion must obtain written waivers of the right to receive an audited Annual Report from each such participant.

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Please do not hesitate to contact us with any questions.

⁶ The CFTC also amended CFTC Regulation 4.22(c)(7) to indicate that the specified waivers of the right to receive an audited Annual Report in respect of the pool's final fiscal year are not required for participants who are CPO-Related Insiders.