

6 February 2017

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CFTC Permits Unaudited Financial Statements Upon Liquidation of a Series of a Pool That is Also a Registered Investment Company

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Introduction

The Commodity Futures Trading Commission (“CFTC” or “Commission”) has provided general exemptive relief to persons registered as commodity pool operators (“CPO”) under the Commodity Exchange Act that operate commodity pools that also are registered with the Securities and Exchange Commission (“SEC”) as registered investment companies (“RIC”).¹ Under the exemptive relief, if the RIC is comprised of more than one series (a “series fund”) and a series is liquidated, and the CPO continues operating one or more of the remaining series, the CPO may provide pool participants and National Futures Association (“NFA”) unaudited final financial statements in lieu of the otherwise required audited financial statements.²

Background

Prior to 2012, the CFTC generally provided an exclusion from the definition of a CPO for operators of RICs, irrespective of the amount of commodity interest trading engaged in by the RIC. In 2012, the CFTC substantially tightened that exclusion so that it would apply only if the RIC (1) engaged in a limited amount of commodity interest trading,³ and (2) is not marketed to the public as a commodity pool or as a vehicle for trading commodity interests. These additional conditions and other amendments to the CPO registration exemptions adopted at that time resulted in hundreds of additional persons being required to register as CPOs. In an effort to ease undue, conflicting, or duplicative regulatory burdens on these RIC CPOs, who are subject to extensive regulatory requirements under SEC rules and requirements imposed by the Financial Industry Regulatory Authority, the CFTC issued its “Harmonization Release” in 2013.⁴ Unfortunately, the Harmonization Release did not specifically address liquidation audits of a RIC with series when the entire RIC is not being liquidated.

¹ The relief is set forth in CFTC Staff Letter No. 17-04, dated January 26, 2017, and is available [here](#).

² NFA is the only registered futures association and is the frontline regulator of CPOs.

³ The trading limitations provide that any commodity interest trading that does not qualify as bona fide hedging must meet one of two tests when a new position is entered into: –(1) the aggregate initial margin and premiums required do not exceed 5% of the liquidation value of the pool’s portfolio; or (2) the aggregate net notional value of commodity interest positions does not exceed 100% of the liquidation value of the pool’s portfolio.

⁴ *Harmonization of Compliance Obligations for Registered Investment Companies Required To Register as Commodity Pool Operators*, 78 Fed. Reg. 52308 (August 22, 2013).

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Treatment of Series Funds

CFTC Regulation 4.22(c)(6) provides that “Where the pool is comprised of more than one ownership class or series, information for the series or class on which the financial statements are reporting should be presented in addition to the information presented for the pool as a whole; except that, for a pool that is a series fund structured with a limitation on liability among the different series, the financial statements are not required to include consolidated information for all series.” CFTC Regulation 4.22(c)(7) permits a CPO of a pool that has ceased operation to file with the NFA, and distribute to pool participants, an abbreviated audited final financial statement in lieu of the full annual report otherwise required.⁵ The CPO also is permitted under CFTC Regulation 4.22(c)(7)(iii) to prepare an *unaudited* abbreviated final financial statement, provided the CPO has obtained written waivers from all of the participants in the pool regarding receipt of an audited report.

Relief Provided

As it would be difficult for RICs to get waivers from investors to avoid incurring the costs of preparing audited financial statements, and as RICs shares are held in accounts with financial intermediaries makes it difficult also to distribute these financial statements directly to investors, the Investment Company Institute requested the CFTC staff to provide relief from these requirements. The relief granted by the CFTC provides that the CPO of a liquidating series of a RIC need only prepare, and provide to participants and NFA, unaudited Statements of Operations and Changes in Net Assets in accordance with CFTC Regulation 4.22(c)(7). The staff orally confirmed to one of the authors that these financial statements can be prepared in accordance with generally accepted accounting principles applicable to investment companies. The statements may be provided either through electronic or physical delivery, either directly to all participants in the series or through the relevant financial intermediaries (such as a broker, bank, trust, or retirement plan) that sells the pool’s shares, as well as to NFA, within 90 days of the permanent cessation of the pool’s trading.⁶ The CFTC also provides relief so that, if the entire corporate entity that constitutes the RIC is liquidated, or there is a concurrent liquidation of all of the series of the RIC, the Form 8-F required to be filed with the SEC, when also provided to NFA, will be accepted as substituted compliance with the RIC’s CFTC Regulation 4.22(c) liquidation report requirement. The relief is provided via exemptive letter issued by the Director of the Division of Swap Dealer and Intermediary Oversight under delegated authority from the Commission, so there is no need for CPOs to request individual no-action relief or to make any notice filing.

⁵ Upon liquidation, the only required statements are Statements of Operations and Changes in Net Assets.

⁶ CFTC Regulations 4.22(c)(7)(ii)(C) and 4.22(f)(1)(i) permit CPOs to request relief from the 90-day time limit if certain conditions are met.

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The authors worked with staff members of the Investment Company Institute to obtain this relief.

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