CFTC Staff Permits CPO to Provide Financial Statements for Onshore Feeder Fund Prepared in Accordance with IFRS In Lieu of U.S. GAAP

CFTC Letter No. 18-09 ("Letter 18-09"):

On March 30, 2018, the Commodity Futures Trading Commission's (the "CFTC" or "Commission") Division of Swap Dealer and Intermediary Oversight ("DSIO") issued an exemptive letter permitting the commodity pool operator ("CPO") of a U.S. feeder fund that is invested in a Cayman Islands master fund which uses International Financial Reporting Standards ("IFRS") to provide participants in the U.S. feeder fund, and file with the National Futures Association, financial statements for the U.S. feeder fund prepared in accordance with IFRS, and reconciled to U.S. Generally Accepted Accounting Principles ("U.S. GAAP") for material differences, in lieu of providing such statements prepared in accordance with U.S. GAAP.

Background:

CFTC Rules 4.7 and 4.22 generally require that a registered CPO prepare and deliver to pool participants both periodic account statements and an audited annual report, each of which must contain certain financial statements. These rules further require that the financial statements be computed and presented in accordance with generally accepted accounting principles, which DSIO has consistently interpreted to mean U.S. GAAP.

However, Rule 4.22(d)(2)(i) permits a CPO to compute and present financial statements in accordance with additional non-U.S. accounting standards, including IFRS, where, among other things, the pool is organized under the laws of a foreign jurisdiction. Here, absent relief, the requestor CPO would not be able to calculate and present the U.S. feeder fund's financial statements in accordance with IFRS—despite doing so for the master fund—because the feeder fund is organized under Delaware law and thus would not meet the foreign organization requirement. DSIO noted that the feeder fund otherwise appeared to meet the remaining requirements under Rule 4.22(d)(2)(i).

Relief and Rationale:

Accordingly, DSIO granted exemptive relief to the CPO from the provisions of Rules 4.7 and 4.22 obligating the CPO to prepare the U.S. feeder fund's financial statements in accordance with U.S. GAAP, on the condition that it prepare them in accordance with IFRS and reconcile them to U.S. GAAP where the IFRS preparation presents a material difference from that statement's preparation in accordance with U.S. GAAP. The relief is applicable solely with respect to the U.S. feeder fund.

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In providing the relief, DSIO stated that requiring the CPO to use U.S. GAAP in the computation and presentation of the U.S feeder fund's financial statements would be inconsistent with the understanding of the fund's participants, who currently receive periodic account statements and annual financial statements presented in accordance with IFRS, and also would obligate the CPO to incur additional expense in having the financial statements recalculated and certified in accordance with U.S. GAAP in addition to the original IFRS preparation. The approach under the relief would provide the U.S. feeder fund's participants with information presented in a manner consistent with the disclosure documents they received, while minimizing the additional expense to the CPO. Moreover, DSIO noted its understanding that financial statements prepared in accordance with IFRS with a separate reconciliation to U.S. GAAP, to the extent that the IFRS presentation would result in a material difference from a U.S. GAAP presentation, would provide the U.S. feeder fund's participants with information that is effectively equivalent to that provided by financial statements prepared pursuant to U.S. GAAP.

Conclusion:

While the relief granted in Letter 18-09 is an interesting development, it is important to note that Letter 18-09 is silent regarding whether the requestor CPO is also a registered investment adviser under the Investment Advisers Act of 1940. Thus, although the exemptive relief could make compliance with financial statement delivery requirements less expensive and more efficient for certain advisory firms (*e.g.*, those operating pure commodity futures funds), firms that are registered investment advisers and use the "audit approach" to satisfy the Securities and Exchange Commission's ("SEC") custody rule will still need to deliver to pool participants financial statements prepared in accordance with U.S. GAAP, except to the extent permissible under the interpretive guidance provided by the staff of the SEC's Division of Investment Management.[1]

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below:

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[1] Staff Responses to Questions about the Custody Rule, Question VI.5 (modified March 10, 2010), *available at* https://www.sec.gov/divisions/investment/custody_faq_030510.htm. This interpretive guidance provides that funds organized outside the United States or having an investment manager with its principal place of business outside the United States may have their financial statements prepared in accordance with accounting standards other than U.S. GAAP so long as they contain information substantially similar to statements prepared in accordance with U.S. GAAP and any material differences with U.S. GAAP are reconciled.

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