



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Swap Dealer and
Intermediary Oversight

Eileen T. Flaherty
Director

CFTC Letter No. 17-53
Exemption
June 19, 2017
Division of Swap Dealer and Intermediary Oversight

Re: Application of Commission Regulation 4.7 to Certain Operators of Non-United States Commodity Pools

Mr. :

This letter is in response to your request dated March 16, 2017 to the Division of Swap Dealer and Intermediary Oversight (“Division”) of the Commodity Futures Trading Commission (“Commission”) on behalf of “A”, “B”, and “C”, (collectively, “D”)¹ requesting relief from certain requirements of Commission Regulation 4.7 as they relate to reporting to pool participants.

Background

You represent the facts to be as follows. “D” is an asset management organization that provides investment advisory and management services globally, but emphasizes managing investment funds and separate accounts in Europe and Australia. As of September 30, 2016, “D” had assets under management of approximately \$, the balance of which are held in funds organized under the laws of various European jurisdictions and offered to investors under the Undertakings for Collective Investment in Transferable Securities regime (“UCITS”) and the Alternative Investment Fund Managers Directive (“AIFMD”). “D’s” ultimate parent is the “E”.

“E” and its wholly-owned insurance company subsidiary “F” have entered into a seeding program with “D”, under which each of “E” and “F” have made investments from their general account assets in non-US commodity pools (“Registered Pools”)² that are operated by “D” pursuant to UCITS and AIFMD laws as applicable, as well as Commission Regulation 4.7. The funds into which “E” and “F” have made investments are otherwise solely marketed and offered to non-US investors. As such, “E” is ultimately the only U.S. investor in these Registered Pools.

Issue

“D” has noted the difficulties they encounter in being required to comply with certain requirements of Commission Regulation 4.7 as well as the UCITS and AIFMD regime. These

¹ “A” owns % of “C” and wholly owns “B”.

² A list of the Registered Pools currently at issue is included in Appendix A to this Letter.

difficulties arise from conflicts between Commission Regulation 4.7 and the laws governing UCITS and AIFMD, for which “D” has pre-existing obligations.

Specifically,

- **Commission Regulation 4.7(b)(1) – The Disclosure Document Disclaimer**

Commission Regulation 4.7(b)(1) requires a CPO to include a specific block-text disclaimer on the cover of a commodity pool’s offering document or, if no such document is issued, above the signature block of each investor’s subscription agreement or other document required to subscribe for interests in the pool.

“D” notes the following difficulties in including the block-text disclaimer in their current offering documents:

- The home country regulator in the European Union for the Registered Pools would have to approve the addition of any new or different language to the cover of a Registered Pool’s offering memorandum. This approval process can be costly and time-consuming. “D” would have to repeat that process each time a new offering document would be issued for a Registered Pool.
- The block-text disclaimer would also present European investors with information they do not typically encounter when investing in other European funds. For instance, those investors may not understand the significance of CFTC CPO registration or why, in the case of a European fund, the fact that the CFTC has not reviewed or approved the offering memorandum may be significant. They may also be unfamiliar with certain CFTC specific terms such as “qualified eligible person” that are not used elsewhere in the offering memorandum.
- The prominence of the block-text disclaimer may cause confusion among investors and put “D” at a competitive disadvantage to other firms that offer similar funds without having registered as CPOs (e.g., other UCITS funds that do not have US seed investors).
- In addition, “D” suggests that the block-text disclaimer will be unlikely to enhance investor protection in light of the substantial disclosures that a Registered Pool must already make in its offering memorandum under its home country laws.

- **Commission Regulation 4.7(b)(2) – Investor Account Statements**

Commission Regulation 4.7(b)(2) requires a CPO to prepare and deliver a periodic account statement to pool participants at least quarterly, within 30 days after the end of each such reporting period. The account statement must include certain information about the pool’s net assets and changes thereto, and it must also include an

affirmation by a representative of the CPO that the information contained therein is accurate and complete.

“D” notes the following difficulties with preparing the periodic account statements consistent with Commission Regulation 4.7(b)(2):

- As with other “D” funds, the Registered Pools prepare detailed monthly reports that, among other things, include the information about pool net asset value required by Regulation 4.7(b)(2). Although “D” is required to produce such reporting under their respective home country laws, the reporting is not fully consistent with Regulation 4.7(b)(2). Notably, under their respective home country laws, they are not required to provide affirmations with respect to the funds’ monthly reporting.
- The home country governance and financial reporting infrastructures for “D” with respect to these Registered Pools have not historically supported a quarterly certification process with respect to their investment funds. Although the firms have developed temporary processes to address Commission Regulation 4.7(b)(2), fulfilling these requirements is time-consuming and costly – particularly in light of the resources they must devote to satisfying the many other requirements that apply to the Registered Pools under their home country laws.
- Moreover, and similar to the block-text disclaimer requirement under Regulation 4.7(b)(1), European investors have indicated they are confused by receiving account statements that refer to the CFTC and Regulation 4.7 requirements. This is likely because those investors do not receive such statements for other European funds in which they invest.

• **Regulation 4.7(b)(3) – Annual Reports**

Regulation 4.7(b)(3) requires a CPO to prepare, distribute to investors, and file with the NFA an audited annual report within 90 days of the end of a commodity pool’s fiscal year.

“D” notes the following difficulties with preparing the audited annual report consistent with Commission Regulation 4.7(b)(3):

- The Registered Pools are already subject to annual report requirements under their home country laws. Those requirements mandate detailed reporting on the assets, liabilities, income, and share activity of each Registered Pool. The Registered Pools’ financial statements required by home country laws also must include appropriate footnote disclosure and must be audited by an independent accounting firm.

- Once produced, annual reports are made available to investors online and at the registered office of the fund's investment manager. They may thereafter be sent to an investor by mail upon the investor's request, as indicated in the relevant fund's offering document.
- Actual delivery to investors is also complicated by the omnibus-type account structure through which investors in the funds hold their interests. Because those larger accounts are maintained by the funds' distributors, "D" would require their assistance in delivering the reports to all investors. Because actual delivery is not the default practice in Europe, it is uncertain whether distributors will be willing or able to assist with such a large-scale process. In addition, the smaller presence of registered CPOs in Europe than in the United States will make it less likely that those distributors will be familiar with Regulation 4.7(b)(3) and willing to accommodate delivery to investors.
- The challenges associated with the affirmation requirement for account statements also apply to the affirmations required for the Registered Pools' annual reports.
- Registered Pools may already be preparing, or intend to prepare financial statements in accordance with an audit standard, such as "G" GAAP, consistent with the UCITS or AIFMD regime, rather than "H" GAAP, or any other standard that the CFTC now permits in lieu of US GAAP. It would be disruptive to the Registered Pools' financial reporting procedures to change the audit standard that they use. In addition, Registered Pool investors would be confused by the reason for such a change.
- Finally, the CPO of a commodity pool operated under Regulation 4.7 is required to disclose that fact on the cover of the pool's annual report. As with the block-text disclaimer required on the cover of a pool's disclosure document, "D" suggests that the annual report legend would be confusing to European investors. Given their general unfamiliarity with the CFTC and lack of any expectation that US investor protections would apply to their investments in the Registered Pools, "D" suggests that the legend should have to be furnished.

"D" anticipates that "E" will continue to seed its Registered Pools. Accordingly, it is likely that the difficulties noted above will continue to apply in the future, so long as "D" would be required to register as a CPO with respect to the Registered Pools.

Investors in the Registered Pools are afforded the same protections that apply to all "D" sponsored funds under the laws of their home countries. As such, "D" suggests that requiring compliance with the identified provisions of Regulation 4.7 in respect of the Registered Pools would provide only incremental investor protections, yet would require significant additional cost, and would conflict with existing home country laws.

Further, the incremental customer protections provided by the requirements of Commission Regulation 4.7 detailed above would benefit a sole US investor in each Registered Pool: “E”, the ultimate parent of the “D”. “E” is a large and highly sophisticated entity with staff dedicated to the investment of its general account assets, including with respect to the Registered Pools. Further, “E” has access to all the information about the Registered Pools that it deems necessary or appropriate to review and evaluate its investments. “D” does not believe that “E” would be harmed in any way by the requested relief. The same analysis would also apply to any seed investment that “F” would make in a Registered Pool.

Relief Requested

Therefore, “D” requests that DSIO provide relief from the following requirements of Regulation 4.7:

1. The requirement to include the block-text disclaimer provided by Regulation 4.7(b)(1) on the cover page of a Registered Pool’s offering document;
2. The requirement to furnish an account statement to investors in a Registered Pool under Regulation 4.7(b)(2);
3. The requirement under Regulation 4.7(b)(3) to include a legend on the cover of a Registered Pool’s annual report that indicates the CPO relies on Regulation 4.7 with respect to that Pool;
4. The requirement under Regulation 4.7(b)(3) to include a signed oath and affirmation in the annual report of a Registered Pool; and
5. The requirement under Regulation 4.7(b)(3) to prepare a Registered Pool’s annual report in accordance with an audit standard specified in the Commission’s Regulations, where the Registered Pool relies on a different standard (e.g., “G” GAAP). Instead, the annual report may be prepared in accordance with the alternative audit standard associated with the Registered Pool. If a Registered Pool uses a different audit standard than specified for purposes of Regulation 4.7(b)(3), the Registered Pool will include a reconciliation to US GAAP when filing an annual report with the NFA. A Registered Pool’s annual report will continue to be made available or distributed to investors in the manner provided under home country laws, while still remaining subject to the requirement under Regulation 4.7(b)(3) to file the annual report with the NFA within 90 days of a Registered Pool’s fiscal year-end.

Relief Granted

When considering the sophistication of “E”, the “D” ultimate parent, and the incremental investor protections that the above stated provisions of Commission Regulation 4.7 would provide to “E”, the Division believes that, in this instance, factors in favor of the “D’s” request

for relief outweigh the incremental investor protections that Commission Regulation 4.7 would otherwise provide.

Accordingly, the Division believes that granting the relief requested on behalf of the “D” is neither contrary to the purpose of Regulation 4.7(b)(3), nor to the public interest. Therefore, pursuant to the authority delegated in Regulations 140.93(a)(1) and 4.12(a), and subject to the CPO’s continued compliance with the conditions stated herein, the “D” is provided exemptive relief with respect to the five enumerated provisions of Commission Regulation 4.7 listed above.

The relief issued by this letter does not excuse persons relying on it from compliance with any other applicable requirements contained in the Commodity Exchange Act or in the Commission regulations issued thereunder. Further, this letter, and the relief contained herein, is based upon the representations made to the Division. Any different, changed or omitted material facts or circumstances might render this letter void. Finally, the Division retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the relief provided herein, in its discretion.

Should you have any questions, please do not hesitate to contact Amanda Olear, Associate Director, at 202-418-5283 or Michael Ehrstein, Special Counsel, at 202-418-5957.

Very truly yours,

Eileen T. Flaherty
Director, Division of Swap Dealer
And Intermediary Oversight

Appendix A

- “T”
- “J”
- “K”
- “L”
- “M”
- “N”