

MEMO# 27480

August 21, 2013

Division of Investment Management Guidance Update on Disclosure and Compliance Matters for Investment Companies that Invest in Commodity Interests

[27480]

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 70-13

COMPLIANCE MEMBERS No. 34-13

SEC RULES MEMBERS No. 76-13

SMALL FUNDS MEMBERS No. 47-13

DERIVATIVES MARKETS ADVISORY COMMITTEE No. 61-13

INVESTMENT ADVISER MEMBERS No. 59-13 RE: DIVISION OF INVESTMENT MANAGEMENT
GUIDANCE UPDATE ON DISCLOSURE AND COMPLIANCE MATTERS FOR INVESTMENT
COMPANIES THAT INVEST IN COMMODITY INTERESTS

The SEC's Division of Investment Management recently released a Guidance Update entitled "Disclosure and Compliance Matters for Investment Company Registrants That Invest in Commodity Interests" ("Update"). [\[1\]](#) The Update explains that, in light of new requirements for certain registered fund advisers to register with the Commodity Futures Trading Commission ("CFTC") as commodity pool operators ("CPOs"), the SEC and CFTC staffs worked together to harmonize the agencies' requirements with respect to disclosure to investors about registered investment company ("fund") investments in commodity interests. [\[2\]](#) The Update addresses four topics, summarized below.

I. Disclosure of Derivatives and Associated Risks

The Update reiterates observations previously made in a 2010 letter to the ICI. [\[3\]](#) Specifically, it states that funds that use or intend to use derivatives should assess the accuracy and completeness of their disclosure. Funds should tailor their disclosure to address how a fund expects to be managed, including the strategies a fund expects will be the most important means of achieving its objectives and that it anticipates will have a significant effect on its performance. This disclosure should include the purpose that derivatives are intended to serve in the portfolio.

Additionally, the principal risk disclosure should similarly be tailored to address the types of derivatives used by the fund, the extent and purpose of their use, and their risk profile. Finally, a fund should review its derivatives-related disclosure annually and assess whether it is complete and accurate in light of the fund's actual operations.

II. Performance Presentations

The Update acknowledges that at times a new fund may seek to include in its prospectus the performance records of other funds or private accounts managed by the same investment adviser. [\[4\]](#) It states that the SEC staff has previously expressed the view that a fund may do so with respect to accounts and funds that have substantially similar investment objectives, policies, and strategies to the fund, provided that the information is not presented in a misleading manner and does not obscure or impede understanding of information that is required to be included in the fund's prospectus. The Update emphasizes that such a fund may not exclude the performance of any other funds or private accounts that have substantially similar investment objectives, policies, and strategies if the exclusion would cause the performance shown to be more favorable than if those funds or accounts were included.

III. Legend Requirement

The Update explains that Rule 481 under the Securities Act of 1933 requires a fund to provide a legend on the cover page of its prospectus indicating that the SEC has not approved or disapproved of the securities or passed upon the accuracy or adequacy of the disclosure in the prospectus. It states that the SEC staff would not object if a fund that invests in commodity interests includes in this legend language that also indicates that the CFTC has not approved or disapproved of the securities or passed upon the accuracy or adequacy of the disclosure. [\[5\]](#)

IV. Compliance and Risk Management

The Update briefly reviews the compliance rules for registered investment advisers (Rule 206(4)-7(a) under the Investment Advisers Act of 1940) and funds (Rule 38a-1 under the Investment Company Act of 1940). In view of these rules, the Update states that the staff expects that funds and their advisers would adopt policies and procedures that address, among other things, consistency of fund portfolio management with the fund's disclosed investment objectives and policies, strategies, and risks.

Finally, the Update notes that the new Risk and Examinations Office within the Division of Investment Management will be visiting investment management firms to increase the staff's understanding of firms' risk management activities, including those related to commodity interests and other derivatives; generate dialogue between the staff and firms on key risk and other issues facing the industry; and help inform policy and the examination process.

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endnotes

[1] The Guidance Update is available at www.sec.gov/divisions/investment/guidance/im-guidance-2013-05.pdf.

[2] See also ICI Memorandum No. 27469 (Aug. 15, 2013), available at www.ici.org/my_ici/memorandum/memo27469 (describing the CFTC's recent adoption of final harmonization rules for fund CPOs).

[3] Letter to Karrie McMillan, General Counsel, ICI, from Barry Miller, Associate Director of the Division of Investment Management, dated July 30, 2010, available at www.sec.gov/divisions/investment/guidance/ici073010.pdf.

[4] The inclusion of prior performance information for funds with less than three years of performance history is a condition of relief of the CFTC's final harmonization rules, but it is limited to the performance of all accounts and pools that are managed by the CPO and that have investment objectives, policies, and strategies substantially similar to the offered fund. See CFTC amended Rule 4.12(c)(3)(i).

[5] The release adopting the CFTC's final harmonization rules states that fund CPOs do not need to include the CFTC's required legend in their prospectuses, provided that they modify the Rule 481 legend to include specified modified Rule 481 language in the adopting release which references the CFTC as well as the SEC.