

MEMO# 30659

March 30, 2017

Update on Submission to SEC Addressing Accounting for Centrally Cleared Derivative Contracts

[30659]

March 30, 2017 TO: ICI Members

Derivatives Markets Advisory Committee SUBJECTS: Derivatives

Fund Accounting & Financial Reporting RE: Update on Submission to SEC Addressing
Accounting for Centrally Cleared Derivative Contracts

As you may know, the Chicago Mercantile Exchange (CME) and LCH.Clearnet Limited (LCH) recently amended their rulebooks to legally characterize variation margin payments for over-the-counter derivatives they clear as settlements of the derivatives' exposures rather than collateral against the exposures. Prior to the changes going into effect, registered funds accounted for changes in value on centrally cleared swaps and the related movement of variation margin as unrealized gains and losses. The CME and LCH amendments have raised questions about whether these unrealized gains and losses on open derivatives contracts cleared through these entities should now be recorded as realized when variation margin is transferred. In addition, the amendments have caused some to reconsider historical accounting for futures contracts.

Members of the AICPA Investment Companies Expert Panel submitted the attached paper addressing the accounting for centrally-cleared derivatives to the SEC staff for its consideration. The paper describes two views: View A argues that the change in fair value of open settled-to-market derivative contracts may be accounted for as unrealized gains and losses until the contract delivery or termination date, at which point they would be reclassified to realized; View B argues that the change in fair value of open settled-to-market derivative contracts may be accounted for as realized gains and losses when variation margin is transferred. The paper then seeks assurance that the SEC staff would not object to accounting for the change in fair value of open derivative contracts (including the historical accounting of futures contracts), for which transfer of variation margin is deemed legal settlement, in accordance with View A.

Recently Matthew Giordano, Chief Accountant in the SEC's Division of Investment Management, and Michael Barkman, Chair of the AICPA Investment Companies Expert Panel appeared on a panel at the ICI Mutual Funds and Investment Management Conference and addressed this topic. Mr. Giordano indicated that the SEC staff would not

object to either View A or View B provided the fund makes a policy election and applies such policy election consistently to all centrally-cleared derivatives for which transfer of variation margin is deemed legal settlement (e.g., a fund that makes a policy election to apply View A must apply this policy election to all centrally-cleared futures and all centrally-cleared swaps for which transfer of variation margin is deemed legal settlement). He indicated that View A is consistent with the SEC's recent amendments to Regulation S-X and new Form N-PORT, which require specific disclosures, including unrealized appreciation/depreciation for investments in derivative contracts. Mr. Barkman noted that, if a fund that previously accounted for the change in value of futures contracts and the related movement of variation margin as unrealized gain/loss decided to change to realized gain/loss consistent with View B, then it would need to consider ASC Topic 250, *Accounting Changes and Error Corrections*, and the need for a letter from the independent accountant as required by Item 77L of SEC Form N-SAR.[\[1\]](#)

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[Attachment](#)

endnotes

[\[1\]](#) Form N-CEN will replace Form N-SAR effective June 1, 2018. Item B.21 of Form N-CEN requires the fund to indicate whether there have been any changes in accounting principles or practices which will materially affect the financial statements. If yes, then Item G.a.iv of the form requires the fund to file a letter from the independent accountant.