

## SEC Risk Alert Cites Frequent Adviser Deficiencies

On February 7, the SEC's Office of Compliance Inspections and Examinations (OCIE) released a [Risk Alert](#) outlining the five areas of most frequently identified examination deficiencies in 2016, including:

- compliance program deficiencies, such as where advisers use compliance manuals that are not tailored to their businesses or that contain specific requirements not followed by the advisers;
- annual CCO reviews that do not address the adequacy and effectiveness of advisers' policies and procedures;
- regulatory filings that are inaccurate or not timely filed;
- Custody Rule violations, including instances where advisers fail to identify that they have custody over a vehicle due to their role as general partner or other authority over the vehicle;
- Code of Ethics violations, including failures to identify access persons and missing or late transaction reports; and
- failure to keep appropriate, updated or consistent books and records under the Books and Records Rule.

These and other items included in OCIE's Risk Alert may be useful for registered advisers performing required annual reviews of their compliance program.

## Executive Order States Administration's Core Principles of Financial Regulation

President Trump issued an [Executive Order](#) on February 3 stating his administration's "Core Principles" for financial regulation, including that regulation be "efficient, effective, and appropriately tailored." The Order directs the Secretary of the Treasury to consult with the heads of the SEC, CFTC and other Financial Stability Oversight Council members and report to the President by June 3 whether particular laws, treaties, regulations, guidance, reporting and recordkeeping requirements, and other government policies promote or inhibit the Core Principles. The Order starts the process of potential regulatory reform, including Dodd-Frank changes, the details of which will emerge over the coming months.

# CFTC Aggregation Rule May Implicate Trading at Controlled Portfolio Companies

A [CFTC Rule](#) effective February 14 may affect private equity firms with controlled portfolio companies that trade in a defined list of agricultural commodities, and the CFTC is considering an expansion to a broader list of regulated contracts.<sup>1</sup>

Intending to curb “excessive speculation” in the commodity markets, the CFTC historically has required market participants to subject their trading in certain commodities to “position limits,” with exclusions for commodities purchased only for the purpose of “bona fide hedging.” The CFTC has required these position limits to apply across all funds or accounts “controlled” by a trader. The amended Rule generally presumes control to exist where traders directly or indirectly own a 10% or greater interest. As this threshold ownership percentage covers substantially all controlled portfolio company investments, a non-hedging transaction at one portfolio company could limit trading in the same commodity by a private equity firm and its other controlled portfolio companies.

The Rule provides exceptions to aggregation (some of which will require notice filings with the CFTC) for certain 10% or greater ownership interests, including for ownership relationships that meet defined criteria for trading independence and for preventing the trader and the owned entity from knowing one another’s trading decisions.

Given the general lack of speculative trading in the covered commodities at portfolio companies typically targeted by private equity, the Rule amendment may not directly affect a significant number of private equity firms; however, managers may receive related inquiries from limited partners who are subject to the position limits regime due to their own commodity trading.

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<sup>1</sup> The Rule currently covers only nine agricultural commodities and options thereon, including: CBOT Corn, CBOT Oats, CBOT Soybeans, CBOT Soybean Meal, CBOT Soybean Oil, CBOT Wheat, ICE Futures U.S. Cotton No. 2, KCBT Hard Winter Wheat and MGEX Hard Red Spring Wheat. In connection with a recent rulemaking proposal, the CFTC is considering expanding the list to 25 physical commodity futures and option contracts in agricultural products, metals and energy contracts, together with their economically equivalent swaps, as described in a recent CFTC [Fact Sheet](#). The proposal’s comment period is ongoing, and it is uncertain whether and to what extent the proposal will be adopted by the CFTC.

If you have any questions about the matters addressed in this *Kirkland AIM*, please contact the following Kirkland attorneys or your regular Kirkland contact.

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