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October 18, 2010

David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: National Futures Association Petition to Amend Commission Regulation 4.5

Dear Mr. Stawick:

Fidelity Management & Research Company and its affiliates ("Fidelity") welcome the opportunity to comment on a petition for proposed rulemaking ("NFA Petition") submitted by National Futures Association ("NFA") regarding the exclusion of specified entities from the definition of commodity pool operator ("CPO") under Commodity Futures Trading Commission Regulation 4.5.[1]

Fidelity is one of the world's largest providers of financial services, with assets under administration of nearly $3.3 trillion, including managed assets of $1.5 trillion. These assets represent the cumulative investments by individuals, retirement plan participants and institutions in over 70 million customer accounts.

Fidelity currently manages over 400 registered investment companies, or mutual funds, many of which utilize futures or options for *bona fide* hedging and other investment purposes. Some of these mutual funds (the "Fidelity Commodity Funds") use a wholly-owned subsidiary to gain exposure to commodities through futures, swaps and other instruments. Other Fidelity-advised mutual funds, including certain asset allocation and target-date funds, invest directly in the Fidelity Commodity Funds in order to gain, efficiently and conveniently, exposure to commodities as an asset class for their investors, most of whom are retail investors and retirement plan participants.

[1] Letter from Thomas W. Sexton, III, Senior Vice President and General Counsel, NFA, to David Stawick, Office of the Secretariat, CFTC (August 18, 2010). NFA withdrew its original June 29, 2010 Petition for Rulemaking to Amend CFTC Regulation 4.5 by separate letter dated August 18, 2010 and resubmitted its petition on August 18, 2010.

Summary

Fidelity believes that the CFTC should not amend Rule 4.5 to require mutual funds to register as CPOs, as the substantial costs and administrative burdens that mutual funds would incur would far outweigh any benefit from such registration. Mutual funds are already subject to a comprehensive set of regulations designed to protect investors from abuse, and additional regulation would be superfluous. In addition, Fidelity believes that requiring mutual funds to register as CPOs could result in some mutual funds ceasing to use commodity futures and options,[2] thereby limiting the tools available to managers who wish to diversify investment risk in their funds, and narrowing the fund choices available to retail investors.

Mutual Funds, and their Use of Futures and Options, are Already Extensively Regulated

Mutual funds are governed by the Investment Company Act of 1940 and the rules promulgated thereunder, and are subject to the oversight of the Securities and Exchange Commission ("SEC"). This comprehensive body of regulation provides ample protection to investors whose mutual funds use futures and options to achieve investment results.

Mutual funds make robust disclosures, including the broad array of information required in a fund's registration statement on Form N-1A. If a mutual fund's principal investment strategy involves trading in, or exposure to, the commodity futures and options markets, the fund must provide comprehensive registration statement disclosure of this strategy and its objectives. Form N-1A also requires disclosure of all relevant risks of investing in a mutual fund and mandates the disclosure of certain performance data, such as year-by-year performance and average annual total return of the fund.[3] In addition, mutual funds are subject to rigorous SEC advertising requirements,[4] produce audited financial statements, make periodic reports to the SEC and fund shareholders and follow exhaustive recordkeeping requirements,[5] similar to the CFTC's requirements for CPOs. NFA has not cited any evidence that investors are being harmed in any way by the CFTC's specific disclosure rules not applying to mutual funds. This is likely owing to the SEC's extensive mutual fund disclosure requirements.

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[2] Although the definitions of "commodity pool operator" and "commodity pool" have been expanded under the Dodd-Frank Wall Street Reform and Consumer Protection Act to include the trading of swaps, NFA's proposed changes to Rule 4.5 appear to apply solely to commodity options and commodity futures. Accordingly, this comment letter applies only to mutual fund investment strategies that relate to futures and options, and not to swaps. Fidelity would strongly oppose any changes to Rule 4.5 that would apply to mutual funds that trade swaps or that provide investment exposure to swaps markets.

[3] See Items 2, 3, 4 and 9 of Form N-1A.

[4] See, e.g., Rule 482 under the Securities Act of 1933, 17 C.F.R. 230.482.

[5] For example, see the reporting requirements in Section 30 of the 1940 Act, 15 U.S.C. §80a-30, and the recordkeeping requirements in Section 31 of the 1940 Act, 15 U.S.C. §80a-31.

A mutual fund's use of futures and options is also subject to a number of substantive restrictions under the 1940 Act and other federal securities laws designed to protect the interests of mutual fund investors. For example, mutual funds are required to segregate liquid assets or hold offsetting positions against obligations that could otherwise result in a "senior security", including derivatives obligations, thereby restraining the amount of leverage mutual funds may obtain.[6] They must also comply with concentration and diversification limits, counterparty restrictions, liquidity requirements and limits on affiliated transactions. Finally, a mutual fund's board generally must be composed of a majority of independent directors or trustees, which provides another mechanism for oversight of fund operations.[7]

NFA suggests in its petition that mutual fund investors should be protected by the benefits of the CFTC's anti-fraud protections. Mutual fund investors, however, are already protected by extensive SEC anti-fraud protections. The 1940 Act and its rules contain numerous provisions designed to protect investors from fraud. For example, mutual funds must adopt written codes of ethics to prohibit fraudulent or manipulative conduct.[8] In addition, advisers to mutual funds must register with the SEC under the Investment Advisers Act of 1940 (the "Advisers Act"), which also contains extensive anti-fraud safeguards, including additional requirements related to advertising.[9] Lastly, mutual funds are subject to the antifraud provisions contained in the Securities Act of 1933 and the Securities Exchange Act of 1934.[10]

NFA's Proposed Rule Change Would Impose Substantial Unnecessary Costs and Burdens on Mutual Funds

Any mutual fund required to register as a CPO could face substantial increased costs and administrative requirements. These burdens would result from, among other things: the requirements of "associated persons" of the CPO (as defined in 17 C.F.R. §1.3(aa)), including all persons in the line of supervisory authority, to pass the National Commodity Futures Examination (known as the Series 3 Exam) and NFA fitness examinations, and pay membership fees to NFA; CFTC and NFA registration; increased reporting requirements to NFA and fund shareholders; and the costs of compliance with an additional regulatory regime, including the provisions of a revised Rule 4.5 itself.

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[6] See Section 18 of the 1940 Act, 15 U.S.C. §80a-18; see also Securities Trading Practices of Registered Investment Companies, Investment Company Act Release No. 10666 (Apr. 18, 1979); *Merrill Lynch Asset Management, L.P.*, SEC No-Action Letter (July 2, 1992); *Dreyfus Strategic Investing & Dreyfus Strategic Income*, SEC No-Action Letter (June 22, 1987).

[7] See Section 10 of the 1940 Act, 15 U.S.C. §80a-10.

[8] See Section 17(j) of the 1940 Act, 15 U.S.C. §80a-17(j).

[9] See Section 206 of the Advisers Act, 15 U.S.C. § 80b-6

[10] For example, see Section 17(a)(3) of the Securities Act of 1933 15 U.S.C. § 77q(a)(3) and Section 10-b of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.

Given the plethora of CFTC and NFA requirements that CPO registration would impose, we expect that the costs of becoming a CPO could be prohibitive for some mutual funds. To the extent mutual fund companies determined that the attendant costs were too high to continue offering exposure to commodity futures and options through mutual funds, retail investors' ability to access commodity markets would be constrained. Rather than being able to invest in mutual funds that utilize (or provide investment exposure to) futures and options to invest in commodities, retail investors would be left with only very limited means to invest in commodities in their portfolios.[11] Less access to commodity markets would result in the diminished ability of investors to diversify their portfolios and mitigate other economic risks, such as inflation and adverse movements in foreign exchange rates. Reduced exposure to commodities in mutual funds could also translate into the potential loss of global purchasing power for these funds and their investors. Additionally, commodity-based mutual funds, together with their wholly-owned subsidiaries, are generally considered long-term liquidity providers to the commodity options and futures markets. Restraints on mutual funds' investments in these instruments may impair liquidity in the futures and options markets referencing commodities and could potentially have a destabilizing effect on commodity prices.[12] In fact, enhancing the liquidity of the futures and options markets was one of the benefits cited by the CFTC in 2003 when it liberalized Rule 4.5 to make it a categorical exclusion for mutual funds.[13]

Mutual Funds that Invest Directly or Indirectly in Commodity Futures and Options Present No Unusual Risk of Harm to the Market

The NFA Petition focused on commodity mutual funds that employ wholly-owned subsidiaries. It is our belief that mutual funds that invest in commodities through subsidiaries, like the Fidelity Commodity Funds, do so to satisfy requirements related to

[11] For many small investors, mutual funds offer the primary means of gaining exposure to the physical commodity markets, which have barriers to entry that might otherwise make it impossible for these investors to obtain commodity market exposure. Mutual funds would be restricted to utilizing strategies such as other types of derivatives, investments in the stocks of commodity producers and holding physical commodities themselves. Each strategy presents its own pros and cons and unique limitations. For example, it is very difficult and relatively uncommon for mutual funds to hold actual physical commodities. Mutual funds should be able to avail themselves of the least costly and most effective investment strategies for their investors, including trading commodity futures and options, without the restraint of unnecessarily costly or inapposite regulations.

[12] Any decreased liquidity could leave commodity producers and commercial end users with unmatched demand, higher costs of hedging and increased risks, as mutual funds and their subsidiaries often take the long side of hedging transactions with these commodity producers and end users. The net result of these adverse effects on trading markets could be higher commodity prices.

[13] The 2003 amendments to Rule 4.5 were intended to, among other things, "encourage and facilitate participation in the commodity interest markets by additional collective investment vehicles and their advisers, with the added benefit to all market participants of increased liquidity." Additional Registration and Other Regulatory Relief for Commodity Pool Operators and Commodity Trading Advisors, 68 Fed. Reg. 12622 (March 17, 2003).

tax law limits on the character of income produced by mutual fund investments.[14] In no way have these subsidiaries been used to evade regulations.[15] In fact, many mutual funds have obtained private letter rulings from the Internal Revenue Service ("IRS") sanctioning their use of subsidiaries.[16] These private letter rulings require the subsidiaries to follow important SEC guidelines set forth in Section 18(f) of the 1940 Act and all related guidance regarding coverage and the use of leverage by mutual funds.[17] Applicable tax law also effectively limits investments by mutual funds in commodities to no more than 25% of a mutual fund's assets by limiting the amount that these funds can invest in subsidiaries.[18] More broadly, the SEC has issued several no-action letters that require mutual funds with subsidiaries to comply collectively with the 1940 Act.[19]

There is no evidence that the use of subsidiaries by mutual funds to gain exposure to commodities creates any extraordinary risk to the commodity futures and options markets. Likewise, Fidelity is not aware of any cases in which it has been alleged, much less demonstrated, that retail investors in such a mutual fund have been harmed by investments by the mutual fund's subsidiary in commodity futures or options.

Mutual Funds Should Not be Subject to the Proposed Marketing Restriction

Although Fidelity does not believe that any changes to Rule 4.5 are warranted, we believe that the proposed marketing restriction would be especially problematic. Prior to the 2003 changes to Rule 4.5, mutual funds relying on the exemption were prohibited from "marketing participations to the public... as or in a vehicle for trading in the commodity futures or commodity options markets." NFA now proposes not only to reinstate this restriction but to broaden it by including the concept of "seeking investment exposure" to commodity futures or commodity options markets. This expansion would likely capture mutual funds that use wholly-owned subsidiaries to gain exposure to commodity futures or options. However, it would potentially apply much more broadly, impacting, for instance, mutual funds that invest in unaffiliated exchange-traded funds ("ETFs"), exchange-traded notes ("ETNs") and similar structures to offer commodity exposure to investors. These mutual funds typically do not trade commodity futures or options

[14] See Subchapter M of the Internal Revenue Code.
[15] CFTC Commissioner Scott O'Malia suggested in a statement in support of the NFA Petition on September 1, 2010 that some mutual funds were using subsidiary structures to avoid regulation.
[16] See, e.g., I.R.S. Priv. Ltr. Rul. 200743005 (July 20, 2007).
[17] 15 U.S.C. §80a-18(f); see also *supra* note 6.
[18] See Section 851(b)(3) of the Internal Revenue Code, 26 U.S. C. § 851(b)(3).
[19] See, e.g., *South Asia Portfolio* SEC No-Action Letter (Mar. 12, 1997), *Templeton Vietnam Opportunities Fund, Inc.* SEC No-Action Letter (Sep. 10, 1996), *The Spain Fund, Inc.* SEC No-Action Letter (Mar. 28, 1988) and *The Scandinavia Fund* SEC No-Action Letter (Nov. 24, 1986). In addition, the SEC issued a no-action letter to Fidelity in 2008, permitting a mutual fund to consolidate a wholly-owned subsidiary used as a vehicle to gain exposure to commodities in the parent fund's financial statements. In doing so, the SEC based its decision on, among other things, the facts and representations that the subsidiary would be operated as if it were a registered investment company under the 1940 Act and that consolidation would give fund shareholders a more accurate picture of the mutual fund's financial position and structure. *Fidelity Select Portfolio* SEC No-Action Letter (April 29, 2008).

themselves and do not use a subsidiary to do so, yet it is unclear whether they would be required to register as CPOs if they were marketed as providing exposure to commodities. We believe that CPO registration would be a particularly illogical result for these mutual funds, as they are only indirectly gaining exposure to the commodities futures and options markets by investing in ETFs and similar vehicles.

More broadly, we do not believe that a marketing restriction on mutual funds that are exempt from Rule 4.5 is appropriate. If NFA's proposed changes were adopted, the *bona fide* hedging and the quantitative limitation on non-*bona fide* hedging (the "5% limit") would provide objective measures to determine whether a mutual fund could remain exempt.[20] However, mutual funds that utilize futures or options for *bona fide* hedging purposes (or within the 5% limit) could still be required to register if the funds concluded that investors would benefit from understanding how these investment options might affect fund returns.[21] For example, asset allocation funds that invest directly or indirectly in commodity futures or options as a very small portion of their portfolios (i.e., within the 5% limit) and include in marketing materials an explanation that an investment in the fund provides some exposure to commodities may no longer be able to rely on the Rule 4.5 exclusion if the broad marketing restriction is adopted. Similarly, the proposed marketing restriction could potentially apply to a broad array of mutual funds that utilize futures and options to gain exposure to asset classes other than physical commodities, e.g., S&P 500 futures, irrespective of whether these strategies are employed for *bona fide* hedging purposes or within the 5% limit. This overly-broad restriction could, therefore, impede the use of certain efficient fund management strategies by some mutual funds.

Equally as important, the notion of a marketing restriction runs counter to the SEC's oft-stated and laudable objectives of transparency and comprehensive disclosure in mutual fund documentation. Imposing a restriction on the marketing of mutual funds trading futures and options could potentially lead mutual funds to provide less disclosure regarding these instruments. This outcome would conflict with an initiative that the SEC

[20] The CFTC acknowledged the subjective nature of the previous marketing restriction when removing it from Rule 4.5 in 2003, stating that "[c]ompliance with the subjective nature of the marketing restriction could give rise to the possibility of unequal enforcement where commodity interest trading is restricted." Additional Registration and Other Regulatory Relief for Commodity Pool Operators and Commodity Trading Advisors; Past Performance Issues, CFTC Final Rule Release, 68 Fed. Reg. 47221 (Aug. 8, 2003).

[21] NFA itself seems to recognize that mutual funds should be allowed to engage in futures transactions for *bona fide* hedging or within the 5% limit without registration in its petition. "NFA recognizes that registered investment companies may need to engage in futures transactions for bona fide hedging purposes and believes they should be permitted to engage a de minimis amount of speculative futures trading without the necessity to be registered with and regulated by the CFTC." See footnote 9 to the NFA Petition. The marketing restriction, however, may result in the unintended consequence of requiring registration of mutual funds that the NFA proposal was not intended to apply to.

is undertaking to further enhance disclosure of the use of derivatives in mutual funds' disclosure documents.[22]

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For the reasons set forth above, Fidelity believes that Rule 4.5 should remain unchanged. We thank the Commission for considering our comments on this important matter and would be pleased to provide any further information or respond to any questions that the Commission or the staff may have.

Sincerely,

Scott C. Goebel

[22] Letter to Karrie McMillan, General Counsel, Investment Company Institute, from Barry D. Miller, Associate Director, Division of Investment Management, Securities and Exchange Commission, July 30, 2010.