MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

October 18, 2010

Via Electronic Mail: NFAamendrule4.5@cftc.gov

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

Re: National Futures Association Petition to Amend Commission Rule 4.5

Dear Mr. Stawick:

Managed Funds Association ("MFA")[1] appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("CFTC" or "Commission") notice and request for comment on the National Futures Association's ("NFA") petition to amend CFTC rule 4.5 ("Rule 4.5").[2] As NFA explains in its petition for rulemaking to amend Rule 4.5 (the "Petition")[3], it is concerned that Rule 4.5 allows entities excluded from the definition of a commodity pool operator to market registered investment companies ("RICs") that are commodity futures investments to retail investors. NFA requests that the Commission amend Rule 4.5—exclusion from the definition of the term "commodity pool operator"—to limit the scope of the exclusion for RICs.

If the Commission determines to amend Rule 4.5 with respect to RICs invested substantially in commodity futures and other derivatives, MFA urges the Commission to consider the differences between the Commission's part 4 regulations concerning commodity pool operators ("CPO") ("Part 4 Regulations") and the Securities and Exchange Commission's ("SEC") regulations under the Investment Company Act of 1940 (the "Company Act"). The two regulatory regimes conflict in certain of their requirements, particularly with respect to certain disclosure requirements, such that compliance with both regulatory regimes is not possible, absent some relief. If the Commission determines to amend Rule 4.5, we respectfully urge the Commission to grant relief where necessary to permit RIC operators to operate under the Part 4

[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $1.5 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

[2] 75 *FR* 56997 (Sept. 17, 2010).

[3] Letter to David Stawick, Secretary, CFTC, from Thomas W. Sexton, III, Senior Vice President and General Counsel, National Futures Association on August 18, 2010, *available at:* http://www.nfa.futures.org/news/newsPetition.asp?ArticleID=3630.

Regulations. However, in doing so, we also urge the Commission to grant comparable relief to traditional public commodity pools to avoid creating a competitive advantage in the marketplace.

I. BACKGROUND

Recently, investment fund sponsors have introduced RICs or "mutual funds" that seek their market exposure, ultimately, from trading in futures and other derivatives (referred to herein as "commodity derivatives mutual funds"). Investment fund sponsors have chosen to structure their commodity derivatives products as RICs for a host of legitimate business reasons, including investor demand for portfolio diversification from exposure to commodities through a familiar mutual fund and tax reporting structure (Form 1099-DIV versus Schedule K-1) and a more cost-effective distribution framework.[4] The operators of these commodity derivatives mutual funds generally file for exclusion under Rule 4.5 with NFA, and as such, do not have to register as CPOs.

NFA's Petition requests that any entity filing for an exclusion from Rule 4.5 with respect to a RIC include in its notice of eligibility a representation that the RIC's qualifying entity:

> (1) will use commodity futures or commodity options contracts solely for *bona fide* hedging purposes (the "*Bona Fide* Hedging Test");
>
> (2) will not have the initial margin and premiums required to establish any commodity futures or commodity options not used for bona fide hedging purposes exceeding five percent of the liquidation value of the qualifying entity's portfolio (the "5% Test"); and
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> (3) will not be marketed to the public as a commodity pool or as a vehicle for investment in commodity futures or commodity options (the "Marketing Test").[5]

The effect of this change would be to repeal the current exemption from registration as a CPO for sponsors of commodity derivatives mutual funds.

II. MFA COMMENTS

MFA is concerned that amending Rule 4.5 pursuant to the Petition would have the effect of requiring commodity derivatives mutual funds and their offering entities to comply with both the regulations under the Company Act and the Part 4 Regulations. While some requirements under these two separate regulatory regimes are similar, in other respects the regulations or CFTC and SEC staff requirements are inconsistent or conflict. Requiring RICs and their offering entities to comply with both regulatory regimes, absent any regulatory relief, could make it impossible or infeasible for CPOs to offer commodity derivatives mutual funds. Accordingly, we respectfully request that in reviewing the Petition and related comments, the Commission consider the differences between the Part 4 Regulations and the Company Act regulations. To the extent the Commission determines to amend Rule 4.5, we respectfully urge the Commission to: (1) grant relief to a CPO offering a commodity derivatives mutual fund from certain aspects of

[4] *See* Section 18(b) of the Securities Act of 1933 (exempting RICs from state regulation of securities offerings).

[5] 75 *FR* 56997.

the Part 4 performance disclosure and disclosure document delivery requirements;[6] (2) grant comparable disclosure document delivery relief to traditional public commodity pools; and (3) amend Rule 4.5 only with respect to the Marketing Test.

A. Relief from Performance Disclosure Requirements

One area where requirements under the Part 4 Regulations and the Company Act regulations differ is with respect to performance disclosures. CFTC Rule 4.24(n) requires the inclusion of past performance of a pool as set forth in CFTC Rule 4.25 ("Rule 4.25") on performance disclosures. Rule 4.25 requires a significant amount of data that is different from the information required or permitted under SEC Form N-1A for RICs.[7] Generally, the SEC restricts investment companies' use of footnotes and does not allow additional performance disclosures beyond the requirements of SEC Form N-1A, such as the performance of other related funds. Furthermore, the Financial Industry Regulatory Authority ("FINRA") also regulates the sales material broker-dealers may distribute and has restrictions on the use of related performance information in sales materials.[8]

The performance disclosure requirements under the Part 4 Regulations and the Company Act regulations are such that it would be impossible for a pool operator to comply with both sets of requirements. We encourage the Commission to engage the SEC on this topic and to reach an agreement with respect to commodity derivatives mutual fund performance disclosures that satisfies both agencies. Indeed, we believe this would be an appropriate issue to raise before the Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues.[9] In the meantime, we

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[6] To the extent other regulatory inconsistencies or conflicts arise, we respectfully request that the Commission consider providing relief as appropriate and raise the issue before the Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues.

[7] For example, performance data required under CFTC Rule 4.25 includes the largest monthly decline during the most recent five calendar months and year-to-date, expressed as a percentage of the pool's net asset value; the worst peak-to-valley draw-down during the most recent five calendar years and year-to-date, expressed as a percentage of the pool's net asset value; performance of each other pool operated by the pool operator (and by the trading manager if the offered pool has a trading manager); and disclosures in certain instances of the performance of each pool operated by and account traded by the trading principals of the pool operator.

Item 4(b)(2) of the SEC's Form N-1A requires disclosure of information, such as a bar chart showing a fund's annual total returns for each of the last ten calendar years subsequent to the effective date of the registration statement; the highest and lowest quarterly return during the ten years covered by the chart (or since inception if less than ten years); a fund's average annual total return for one, five and ten calendar year periods (as well as after taxes on distributions and after taxes on distribution and redemption); and the returns of an appropriate broad-based securities market index for the same periods.

[8] *See* NASD Rule 2210.

[9] We also note that the CFTC and SEC's joint report to Congress on harmonization of regulation recommends that the two agencies align specific private fund reporting requirements, including: "(i) the use of performance track records; (ii) requirements applicable to investor reports (including the financial statements often used by registered investment advisers to comply with the Advisers Act custody rule and the financial statements delivered to investors by commodity pool operators); and (iii) recordkeeping requirements." Some of these differences or conflicts in reporting requirements also become applicable as the Commission seeks to amend Rule 4.5.

respectfully request that the Commission grant relief to a CPO that offers a commodity derivatives mutual fund regulated under the Company Act from the requirements of Rule 4.25 that conflict with the requirements of SEC Form N-1A.

B. Relief from Disclosure Document Delivery Requirements

1. Commodity Derivatives Mutual Funds

The prospectus delivery requirements under federal securities laws applicable to RICs differ from disclosure document delivery requirements under CFTC Rule 4.21 ("Rule 4.21")[10] with respect to receipt and timing. We believe compliance with both CPO and RIC document delivery requirements would be unnecessarily cumbersome and would needlessly interfere with the established document delivery procedures for RICs. Further, we believe that technological advancements since the inception of Rule 4.21, such as the development of the Internet, address earlier investor protection concerns with respect to accessibility of a pool prospectus or other information relating to the investment.[11] We also note that in other circumstances the Commission has provided, or is considering providing, certain CPOs relief from Rule 4.21 conditioned upon a CPO: making its disclosure document available on its website; clearly informing prospective participants of the availability of the disclosure document and the Internet address for accessing it; directing any selling agent to whom the pool operator sells units of participation to inform prospective participants where they could obtain disclosure documents; and complying with disclosure requirements.[12]

To avoid unnecessary, duplicative and cumbersome regulation, we respectfully request that the Commission grant relief to a CPO that offers a commodity derivatives mutual fund from the disclosure document prior delivery and acknowledgment of receipt requirements of Rule 4.21 provided that:

(1) the commodity derivatives mutual fund's disclosure document is readily accessible on a website maintained by the CPO;

(2) the Internet address is disclosed to prospective fund investors;

(3) any selling agent would be directed by the CPO to inform investors where they could access the disclosure document; and

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See A Joint Report of the SEC and CFTC on Harmonization of Regulation, October 16, 2009, *available at:* http://www.cftc.gov/ucm/groups/public/@otherif/documents/ifdocs/opacftc-secfinaljointreport101.pdf.

[10] Rule 4.21 requires a CPO to deliver to a prospective participant a disclosure document prepared in accordance with Rules 4.24 and 4.25, and for the CPO to receive a signed and dated acknowledgment of receipt of the disclosure document before the CPO accepts or receives funds from the prospective participant.

[11] For example, investors in commodity derivatives mutual funds can find end-of-day performance from the website of their fund sponsor, as well as other public sites, and are offered daily liquidity.

[12] *See* Commodity Pool Operators: Relief from Compliance with Certain Disclosure, Reporting and Recordkeeping Requirements for Registered CPOs of Commodity Pools Listed for Trading on a National Securities Exchange; CPO Registration Exemption for Certain Independent Directors or Trustees of These Commodity Pools, 75 *FR* 54794 at 54795 (Sept. 9, 2010).

(4) the CPO complies with applicable Company Act and/or Part 4 Regulation disclosure requirements.

We respectfully suggest that these changes, modeled on the Commission's own prior actions, would promote accessibility of disclosure documents and afford meaningful protections to purchasers.

2. Traditional Public Commodity Pools

In requesting that the Commission grant CPOs that offer commodity derivatives mutual funds with relief from Rule 4.21, we also respectfully urge that the Commission grant comparable relief to traditional public commodity pools to avoid creating a competitive disadvantage in the marketplace. Indeed, we believe it would be appropriate and consistent with the interests of pool participants for the Commission to modernize Rule 4.21 to take into consideration the accessibility of disclosure documents and other relevant pool information via the Internet. As a result of the Internet and the development of electronic communications, investors today have an easier time accessing relevant investment information.

We respectfully request that the Commission grant relief to a CPO from the prior delivery and acknowledgment of receipt requirements of Rule 4.21 provided that:

(1) the public commodity pool's disclosure document is readily accessible on a website maintained by the CPO;

(2) the Internet address is disclosed to prospective pool participants;

(3) any selling agent would be directed by the CPO to inform participants where they could access the disclosure document; and

(4) the CPO complies with Part 4 Regulation disclosure requirements.

C. Use of the *Bona Fide* Hedging Test and 5% Test Are Not Necessary to Achieve the Goals of the Petition

NFA states in the Petition that it "is interested in ensuring that [RICs] that engage in more than a *de minimis* amount of futures trading and that are offered to retail customers or are marketed to retail customers as a commodity pool or otherwise as or in a vehicle for trading in (or otherwise seeking investment exposure to) the commodity futures or commodity options markets are subject to the appropriate regulatory requirements and oversight by regulatory bodies with primary expertise in commodity futures."[13] NFA's objectives can be achieved without use of the *Bona Fide* Hedging Test or the 5% Test. In amending Rule 4.5, we believe the requirement that a RIC not be marketed to the public as a commodity pool or as a vehicle for investment in commodity futures or commodity options—the Marketing Test—would be a sufficient test for addressing NFA's concerns.

[13] *See* Petition *supra* note 3.

The Company Act establishes a stringent disclosure regime for investor protection. Sponsors of commodity derivatives mutual funds will need to disclose the RIC's goal of obtaining returns from actively managed futures strategies or market themselves as commodity derivatives investments. It would be difficult for a retail investor to determine what he or she was investing in or the purpose of a particular RIC if the RIC's disclosure or sales material did not provide a clear description of the RIC's primary objective—*i.e.*, investing in commodity derivatives.

We believe use of the *Bona Fide* Hedging Test and the 5% Test are not necessary in amending Rule 4.5 to achieve NFA's interests. Moreover, in light of the growth of the use of derivatives generally and the significant amendments to the Commodity Exchange Act under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), we believe the Commission should consider and assess these changes in order to understand the likely market impact of the Petition before adopting final amendments to Rule 4.5. For example, it is unclear how new Dodd-Frank Act section 737(c) on *bona fide* hedging transaction, and the Commission's rules thereunder, will affect application of the *Bona Fide* Hedging Test. Similarly, it is unclear whether the Bona Fide Hedging Test and the 5% Test would be appropriate quantitative tests as transactions not previously considered commodity interests, such as interest rate, currency and foreign exchange contracts may be treated as commodity interests in many circumstances under the Dodd-Frank Act.[14] Given these changes, we believe it would be advisable for the Commission to review the implications of the Dodd-Frank Act with respect to the Petition before considering the *Bona Fide* Hedging Test and the 5% Test.

If the Commission determines to amend Rule 4.5, we respectfully urge that the Commission amend Rule 4.5 only with respect to the Marketing Test. To the extent the Commission is interested in requiring a quantitative test, we respectfully urge that the Commission examine the Petition with respect to the Dodd-Frank Act amendments and that the Commission solicit for alternative tests that would better achieve the Commission's goals than the *Bona Fide* Hedging Test and the 5% Test.

III. CONCLUSION

To the extent the Commission finds it appropriate to amend Rule 4.5, we respectfully urge the Commission to consider differences, including conflicting requirements, between certain aspects of the Part 4 Regulations and the Company Act regulations. As discussed, we believe that without regulatory relief from at a minimum certain Part 4 Regulations, it will not be viable for CPOs to offer commodity derivatives mutual funds. We believe there are many legitimate business reasons for a CPO to offer a commodity derivatives mutual fund and oversight by the SEC and CFTC/NFA would offer investors the highest level of investor protection. As such, if the Commission determines to amend Rule 4.5, we respectfully request that the Commission: (1) grant relief to a CPO offering commodity derivatives mutual fund from certain performance disclosure and prior disclosure document delivery requirements; (2) grant comparable disclosure document delivery relief to traditional public commodity pools; and (3) amend Rule 4.5 only with respect to the Marketing Test. MFA supports providing investors in these products with meaningful disclosures and other investor protections. Accordingly, we respectfully urge the Commission to work with the SEC to minimize inconsistencies and conflicts in disclosure requirements for the benefit of investors.

[14] *See* Sections 721(a)(5) and (21) under the Dodd-Frank Act (defining "commodity pool" and "swap").

MFA appreciates the opportunity to comment on the Commission's notice and request for comment on the Petition. We would be pleased to meet with the Commission or its staff to further discuss our comments. If the staff has questions or comments, please do not hesitate to call Jennifer Han or the undersigned at (202) 367-1140.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director,
General Counsel

CC: The Hon. Gary Gensler, Chairman
The Hon. Michael Dunn, Commissioner
The Hon. Jill E. Sommers, Commissioner
The Hon. Bart Chilton, Commissioner
The Hon. Scott D. O'Malia, Commissioner
Mr. Ananda Radhakrishnan, Director
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Mr. Kevin P. Walek, Assistant Director
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