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April 12, 2011

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

Re: Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations; RIN 3038—AD30

The Independent Directors Council ("IDC")[1] appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("Commission") proposal to modify the criteria for registered investment companies ("funds") to claim exclusion from the definition of the term "commodity pool operator" ("CPO") under the Commodity Exchange Act ("CEA") in accordance with Rule 4.5 of the Commission's regulations.[2] Fund directors and trustees oversee the management and operation of funds on behalf of over 90 million shareholders and have a unique perspective on the fund regulatory framework and the protections it provides to investors.[3] The Commission's proposal raises numerous issues and concerns for funds that provide shareholders with some degree of exposure to commodity futures, commodity options, and swaps as part of diversified, securities-based investment

[1] IDC serves the fund independent director community by advancing the education, interaction, communications, and policy interests of fund independent directors. IDC's activities are led by a Governing Council of independent directors of Investment Company Institute member funds. ICI is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts. Members of ICI manage total assets of $13 trillion and serve over 90 million shareholders, and there are approximately 2,000 independent directors of ICI member funds. The views expressed by IDC in this letter do not purport to reflect the views of all fund independent directors.

[2] Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 76 Fed. Reg. 7975 (Feb. 11, 2011).

[3] An investment company may be organized as a corporation, with a board of directors, or as a business trust, with a board of trustees. This letter's references to "fund directors" refer to both directors and trustees of registered investment companies.

portfolios. Those issues will be addressed by other commenters, including the Investment Company Institute.[4] IDC will focus its comments on the potential implication of the proposal for fund directors.

Rule 4.5 currently excludes certain "otherwise regulated entities," including funds, from CPO regulation if the entity files a notice of eligibility with the National Futures Association that includes certain representations. Prior to 2003, the notices of eligibility had to include representations that the use of commodity futures and commodity options for non-*bona fide* hedging purposes would be limited to five percent of the liquidation value of the qualifying entity's portfolio and that the entity would not market the fund as a commodity pool to the public. In 2003, the Commission eliminated those restrictions. When the Commission announced its intention to remove the limits on commodity interest trading, it stated that the amendments were intended to allow greater flexibility and innovation and to encourage and facilitate participation in the commodity interest markets, with the added benefit to all market participants of increased liquidity.[5] Following its review of the comments filed on the proposed amendments, the Commission determined also to eliminate the marketing restrictions, recognizing that the "otherwise regulated" nature of the qualifying entities would provide adequate customer protection.[6]

The Commission now proposes to reinstate the pre-2003 trading and marketing restrictions, with some additional constraints (*e.g.*, the restrictions would extend to a fund's positions in swaps, in addition to its positions in commodity futures and commodity options). Under the proposed amendments, funds would have to restrict their exposures to commodity futures, commodity options, and swaps and comply with the marketing restrictions or the exclusion from CPO regulation provided by Rule 4.5 would not be available.

The Commission acknowledges that the structure of funds may result in operational difficulties with respect to compliance with CPO regulations. Indeed, because of their different structure, funds do not fit neatly within the CPO regulatory regime. While a CPO may be an individual or organization that operates a commodity pool and solicits funds for that commodity pool, a fund is itself a pool of assets that is managed by an adviser, pursuant to an advisory contract, and overseen by a fund board. Because a fund has no employees, it relies on the adviser and other service providers to run the

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[4] See Letter from Karrie McMillan, General Counsel, Investment Company Institute, to David A. Stawick, Secretary, Commodity Futures Trading Commission regarding Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, RIN 3038-AD30 (April 12, 2011) ("ICI Letter").

[5] Additional Registration and Other Regulatory Relief for Commodity Pool Operators and Commodity Trading Advisors, 68 Fed. Reg. 12622, 12625 (March 17, 2003).

[6] Additional Registration and Other Regulatory Relief for Commodity Pool Operators and Commodity Trading Advisors; Past Performance Issues, 68 Fed. Reg. 47221, 47223 (August 8, 2003).

fund's day-to-day operations. The board oversees the performance of those entities under their respective contracts and monitors potential conflicts of interest.

The Commission's proposing release is silent regarding which entity—the fund, its investment adviser, or its directors—would be required to register as a CPO where the Rule 4.5 exclusion is not available. IDC agrees with ICI's assertion that, where the Rule 4.5 exclusion is not available, the adviser—and not the fund or its directors—is the appropriate entity to serve as the fund's CPO, for the reasons discussed in ICI's letter.[7] To avoid any confusion on this matter, IDC urges the Commission to make the following clear: that fund directors would not be required to register as CPOs and would not be subject to regulation as CPOs where a fund does not qualify for the Rule 4.5 exclusion.

When the Commission adopted Rule 4.5 in 1985, it addressed the issue of how to determine the individual or entity that is acting as a CPO with respect to a commodity pool. As examples, it referred to these factors: (i) who is the individual or entity that will be promoting the pool by soliciting, accepting or receiving from others, funds or property for the purpose of commodity interest trading; (ii) who is the individual or entity that will have the authority to hire (and to fire) the pool's commodity trading advisor; and (iii) who will have the authority to select (and to change) the futures commission merchant ("FCM") that will carry the pool's commodity interest trading account.[8]

Looking at these factors, it seems evident that the Commission was not contemplating that fund independent directors would register as CPOs.[9] Fund independent directors do not solicit, accept, or receive investments from others for the purpose of commodity interest trading, nor are they primarily responsible for selecting the FCM that will carry the fund's commodity interest trading account. Rather, these functions typically are carried out by the fund's sponsor (which is typically its investment adviser) and other service providers (such as the fund's principal underwriter) because, as noted above, funds do not have any employees and rely on their investment advisers and other service providers for the day-to-day management of, and decisions regarding, the fund. In this connection, fund boards serve an oversight role and monitor the performance of the fund's service providers. In addition, fund directors have the authority to approve and terminate a fund's agreement with its investment adviser (which typically also would be considered the commodity trading advisor), although termination is a drastic and costly step and generally inconsistent with the expectations of shareholders, who presumably invested in the fund based upon the adviser's investment strategy and performance record.

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[7] See ICI Letter, *supra* n. 4.

[8] *See* Commodity Pool Operators; Exclusion for Certain Otherwise Regulated Persons from the Definition of the Term "Commodity Pool Operator"; Other Regulatory Requirements, 50 Fed. Reg. 15868 at n.26 (Apr. 23, 1985).

[9] An independent director of a fund is not affiliated with the adviser and does not otherwise fall within the definition of "interested" director under Section 2(a)(19) of the Investment Company Act of 1940 ("1940 Act").

The Commission has previously recognized that registration of individual directors and trustees is not practicable or necessary.[10] The same may be said in this instance. The policy rationale for the Commission's proposal (*i.e.*, to stop the practice of funds offering futures-only investment products without Commission oversight) would not be furthered by subjecting individual fund directors to Commission regulation. Moreover, requiring fund directors to register as CPOs is wholly inconsistent with their oversight role. Fund directors *oversee* the management and operation of funds on behalf of fund shareholders; they do not directly "manage" or "operate" the fund. Requiring a director to comply with the requirements of a CPO, such as to pass a fitness test and the Series 3 exam, would impose unnecessary and burdensome obligations on directors for no apparent reason.[11] Clearly, these requirements are not related or relevant to their oversight responsibilities. Fund directors are already subject to significant and important responsibilities that are appropriately tailored to their oversight role.[12] The added and unnecessary burden of CPO registration and regulation could very likely deter qualified persons from serving as fund directors, to the detriment of fund shareholders.

Fund shareholders are well protected by the oversight provided by fund boards, and will continue to be protected, regardless of whether the adviser or the fund itself is registered as a CPO. Fund directors are subject to state law fiduciary duties of loyalty and care, in addition to the responsibilities imposed on them under the federal securities laws. Most boards are composed of at least 75 percent independent directors,[13] and, according to the Supreme Court, these directors have "the primary responsibility" for looking after the interests of the fund's shareholders and serve as "independent watchdogs" on their behalf.[14]

Because there are no policy reasons to require independent directors to register as CPOs, and there are numerous detrimental consequences in doing so, IDC urges the Commission to clarify that

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[10] *See* CFTC Letter No. 10-06, No Action Exemption (March 29, 2010) (concerning directors of commodity exchange traded funds that were not registered investment companies under the 1940 Act).

[11] Persons may not serve as fund directors if they are subject to any disqualifications in Section 9 of the 1940 Act.

[12] The 1940 Act requires fund directors, and separately, independent directors, to annually review and approve the advisory contract. Fund boards are also tasked with, among others, approving the auditor and principal underwriter for the fund and making fair value determinations for certain securities held by the fund. Securities and Exchange Commission rules further require boards to oversee a variety of transactions involving potential conflicts of interest between the fund and its investment adviser or the adviser's affiliates. Boards also oversee the audit and compliance functions, and must approve written compliance policies and procedures designed to prevent violations of federal securities laws.

[13] *See Overview of Fund Governance Practices, 1994-2008* (available at http://www.idc.org/pdf/pub_09_fund_governance.pdf).

[14] *See Burks v. Lasker*, 441 U.S. 471, 484-85 (1979).

fund independent directors are not required to (1) register as CPOs, or (2) comply with the CPO provisions of the CEA and the rules thereunder where the fund does not meet the criteria for the exclusion provided by Rule 4.5.

For the same reasons, IDC urges the Commission to clarify that the independent directors of funds would not be deemed to be principals or associated persons of a CPO where the fund does not meet the criteria for the exclusion provided by Rule 4.5. If the adviser is deemed the CPO, independent directors should not be treated as principals or associated persons, because they are not and cannot be affiliated with the adviser. Indeed, if, for example, the adviser is organized as a corporation, it may have its own board of directors that oversees the adviser's operations. If the fund itself is deemed the CPO—which, as noted above and discussed further in ICI's letter, IDC does not believe would be appropriate—the Commission's policy reasons for the proposal would not be furthered by imposing the additional, unnecessary burdens on individual independent directors who already have significant responsibilities on behalf of fund shareholders and, who, as previously noted, are already subject to disqualifications under the 1940 Act.

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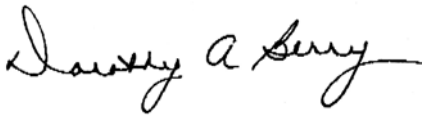
If you have any questions about our comments, please contact Amy B.R. Lancellotta, Managing Director, at (202) 326-5824.

Sincerely,



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