STATEMENT OF THE ASSOCIATION OF INSTITUTIONAL INVESTORS

CFTC Roundtable on Issues Faced by Managed Funds Industry Members with Respect to the Proposed Revision to Commission Regulation 4.5 and Proposed Rescissions of Commission Regulations 4.13(a)(3) and (a)(4)

The Association of Institutional INVESTORS[1] (the "Association") appreciates the CFTC's invitation to participate in this roundtable to discuss the Commodity Futures Trading Commission ("CFTC" or "Commission") proposed rule titled "Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations" (the "proposed rule").[2] Under the proposed rule, the Commission offers revisions to Regulation 4.5 and a rescission of exemptions from Commodity Pool Operator ("CPO") registration under Regulation 4.13(a)(3) and (a)(4).

We encourage the CFTC to make no changes to the current exclusion from the definition of CPO under Regulation 4.5 and to retain the current exemptions from registration as a CPO under Regulation 4.13(a)(3) and (a)(4). With respect to Regulation 4.5, registered investment companies ("RICs") affected by these changes are already subject to robust regulatory requirements and federal oversight, including registration, reporting, and disclosure requirements under the Investment Company Act of 1940 and other federal securities laws. These laws include, among other things, limits on the use of leverage and anti-fraud provisions. Without substantial justification, we believe the costs of subjecting RICs to two different, and sometimes conflicting, regulatory regimes under two separate regulators outweigh any benefits of regulation by the CFTC. With respect to Regulation 4.13(a)(3) and (a)(4), the investors in these private funds are sophisticated investors and most of the investment advisers that advise private funds eligible for these exceptions are or will be regulated, under the Investment Advisers Act of 1940.

The Commission should delay any rulemaking on this proposed rule until major rulemakings required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") are in place. The Dodd-Frank Act does not require this proposed rule. If the Commission determines that changes are necessary, any changes should only be proposed after major Dodd-Frank Act rules are in place. By doing so, the Commission will ensure that both it and the industry fully understand the effects of final Dodd-Frank Act rulemakings and ensure that any rulemaking related to

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[1] The Association of Institutional INVESTORS is an association of some of the oldest, largest, and most trusted investment advisers in the United States. Our clients are primarily institutional investment entities that serve the interests of individual investors through public and private pension plans, foundations, and registered investment companies. Collectively, our member firms manage ERISA pension, 401(k), mutual fund, and personal investments on behalf of more than 100 million American workers and retirees. Our clients rely on us to prudently manage participants' retirements, savings, and investments. This reliance is built, in part, upon the fiduciary duty owed to these organizations and individuals. We recognize the significance of this role, and our testimony is intended to reflect not just the concerns of the Association, but also the concerns of the companies, labor unions, municipalities, families, and individuals we ultimately serve.

[2] *See* Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 76 Fed. Reg. 8,068 (February 11, 2011).

Regulations 4.5 and 4.13(a)(3) and (a)(4) are proper and justified. Waiting to implement these proposed changes will also allow the Commission and the industry to first fully focus on properly implementing mandated Dodd-Frank Act rulemakings.

Before moving forward with the proposed rule, the Commission should also collect certain data from the industry. This would allow the Commission to provide a meaningful cost-benefit analysis in the proposed rule, as it would be able to better estimate the potential costs of the proposed rule. The Commission can require the industry to validate the number of filed exclusions or exemptions under Regulations 4.5, 4.13(a)(3) and 4.13 (a)(4) and collect data from the industry on the extent and purpose of the use of commodity futures, options on futures and swaps by entities that have filed for those exclusions or exemptions.

Should the Commission decide to move forward with this proposed rule, the Association suggests that the Commission first re-propose the rule and provide an additional comment period. In the re-proposal, the Commission should make clear its rationale for the proposed changes and provide a more detailed cost-benefit analysis. Currently the Commission's proposal with respect to Regulation 4.5 notes it is merely "an appropriate point at which to begin discussions." As the relevant Dodd-Frank Act rulemakings become final and as the Commission begins to collect additional data on the current exclusions or exemptions, we believe that a re-proposal will allow the industry to provide proper, informed feedback on the proposals to assist the Commission in drafting appropriate and cost effective final rules.

If the Commission decides to go ahead with the proposed rule as currently drafted, several changes must be made. With respect to RICs, first, the proposed language on Regulation 4.5 must be narrowed significantly: swaps should not be included in the proposed changes; the five percent limitation should be increased significantly and should not include any positions entered into for risk management purposes; and the marketing restriction should be removed. Second, for any RICs that fail this reproposed test, the Commission should require registration with the Commission and certain reporting requirements but not subject these funds to any of the Commission's Part 4 requirements. Third, the Commission should also ensure that the proposed changes to Regulation 4.5 and Regulation 4.13 do not have an adverse effect on RICs that utilize a separate subsidiary structure to invest in commodity-related instruments. Lastly, with respect the exemptions under Regulation 4.13(a)(3) and (a)(4), the Commission should not repeal these exemptions but should simply amend them to include similar limitations as those that would be applicable to the exclusion under Regulation 4.5. We discuss each of these changes in more detail below.

Swaps should not be included in the proposed changes to Regulation 4.5. Swaps will already be subject to substantive regulation under the Dodd-Frank Act including reporting and anti-disruptive trading practices requirements. Furthermore, if the CFTC proceeds with this proposed rule prior to finalizing Dodd-Frank Act rulemakings, it is unclear how the Commission could include swaps, as they have not defined the term "swap" or instituted margin requirements for cleared and uncleared swaps. Without final rules on all of these issues, commenters are unable to provide any meaningful feedback to the Commission on the impacts of including swaps in any of these proposed rule changes.

Further, the five percent limitation in the proposed changes to Regulation 4.5 should be increased significantly and should not include any positions entered into for risk management purposes. The Commission's revised language includes a five percent limitation on positions taken for non bona-fide hedging purposes. The Commission should increase the five percent limitation significantly, particularly if swaps remain in the proposed language. Once the Commission promulgates final rules

dictating the margin requirements for cleared and uncleared swaps and the industry absorbs the changes, the Commission will be in a better position to determine the proper percentage limitation. The Commission should also expand the "hedging exemption" to specifically include transactions entered into for risk management purposes. Using futures, options on futures, or swaps for risk management purposes allows RICs to manage the risks in their investment portfolios and does not create the commodity market risks caused by speculation.

The Association also believes the Commission should remove the marketing restriction from the proposed changes to Regulation 4.5. The Commission does not adequately explain in the proposed rule how this restriction assists the Commission in fulfilling its stated goals and they do not address the intended scope of the restriction. Without sufficient justification, the test appears arbitrary and subjective, requiring industry participants to guess whether they meet the restriction. As the ramifications of exceeding the marketing restriction are substantial, the Commission at a minimum should narrow the restriction, providing guidance and an easily determinable bright line registration test that meets the Commission's goals and allows market participants to clearly determine whether they must register. Among the changes necessary to appropriately limit the marketing restriction, the Commission should remove the parenthetical language "or otherwise seeking investment exposure to." To the extent that this language is meant to cover funds that invest in commodities through commodity linked notes, it should not apply, as the Association does not believe the CFTC has jurisdiction over commodity linked notes, and therefore, a fund should not have to register as a CPO because of its investments in commodity linked notes.

For any RIC that fails this re-proposed test, the Commission should require registration with the Commission and certain reporting requirements but not subject the fund to any of the Commission's Part 4 requirements. The registration and reporting requirements would provide the Commission with most of the benefits of the proposed rule without all the costs of dual and sometimes conflicting regulation.

The Commission should also ensure that the proposed changes to Regulation 4.5 and Regulation 4.13 do not have an adverse effect on RICs that utilize a separate subsidiary structure to invest in commodity-related instruments. Currently, RICs use these structures for tax purposes, not to evade regulation under the Investment Company Act. Under the current proposed changes, any instruments held for non-hedging purposes must be held directly "by a qualifying entity only." To the extent that this language was meant to effectively preclude RICs from using a subsidiary structure, we think the language should be stricken. Furthermore, a subsidiary that is wholly owned by a RIC should be allowed to continue to rely on an exemption under Regulation 4.13.

With respect the exemptions under Regulation 4.13(a)(3) and (a)(4), the Commission should not repeal these exemptions but should simply amend them to include similar limitations as those that would be applicable to the exclusion under Regulation 4.5. We believe private pools that restrict the use of commodity futures, options on futures or swaps to hedging and risk management activities or fall within the quantitative limitations adopted for Regulation 4.5 should be exempted from CPO registration under Regulations 4.13(a)(3) and (a)(4).

The CFTC must also ensure that it harmonizes any revisions to Regulation 4.5 applying to RICs with regulations instituted by the Securities and Exchange Commission (SEC). As currently drafted, these proposed rule changes would subject RICs to duplicative and sometimes inconsistent requirements under the Investment Company Act and the Commodity Exchange Act. The Commission must reconcile any inconsistencies and harmonize the regulatory regimes, and then re-

propose the rule, explaining how RICs will comply with both regimes and how conflicting and inconsistent regulations will be reconciled. Also, any overlap with the Investment Advisers Act rules must be harmonized for any private pools advised by registered investment advisers under any revisions adopted to Regulation 4.13. Without this analysis and an additional notice and comment period, affected entities will not receive the opportunity to comment on the proposed rule changes in accordance with the Administrative Procedures Act.

For any RIC that is no longer eligible for the exclusion, the CFTC should clarify that the investment adviser to the RIC is the appropriate entity to serve as the company's CPO, rather than the RIC itself or its directors or trustees. A RIC typically has no employees and relies on its adviser to establish the company and perform the day-to-day operational tasks for the entity. Permitting the adviser to register as the CPO will ensure the RIC has the ability to satisfy the CFTC's requirements for disclosure and reporting, and ensure that adequate records are maintained and available for regulatory inspection. It would also be consistent with the current CPO model, in which the pool operator, not the pool itself, registers with the CFTC.

Finally, the Association believes it is essential for the Commission to provide adequate time for investment advisers and RICs to change their operations and policies and procedures to comply with any amendments.

The Association appreciates the Commission's efforts to create a dialogue with the industry on these important issues. We are committed to assisting the Commission with implementing rulemakings that protect investors and the markets in which they invest. We are happy to answer any questions the Commission may have on this written statement and look forward to discussing these and other issues in detail with other roundtable participants and the Commission.