NATIONAL FUTURES ASSOCIATION
CFTC PUBLIC ROUNDTABLE
PROPOSED CHANGES TO REGISTRATION AND COMPLIANCE REGIME FOR COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS
July 6, 2011

NFA fully supports amending Regulation 4.5 to reinstate certain operating restrictions that are similar to those that were part of the 4.5 exclusion prior to 2003 for entities seeking to be excluded from the definition of CPO under this provision. In fact, NFA filed a Petition for Rulemaking last summer requesting that the Commission amend the Regulation to reinstate certain trading and marketing restrictions. Although NFA continues to support the concept of amending Regulation 4.5, after further consideration and consultation with managed fund representatives on both the mutual fund and public commodity pool side, NFA has developed a slightly different approach to the amendments, which we believe will more precisely address the concerns that were the basis of our Petition and the Commission's regulatory objectives. A full discussion of this alternative approach is set forth in NFA's comment letter dated April 12, 2011.

NFA filed the Petition for Rulemaking after we became aware of a number of mutual funds that were being marketed to retail investors as commodity futures investments. These funds were invested substantially in derivatives and futures products and were being offered to retail investors in some cases for investment amounts of as little as $1,000. The operators of these funds were not registered as CPOs because of the 4.5 exclusion.

Because there are no marketing restrictions and no limits on the types of customers that can invest in these funds, these funds can be sold to retail investors that are not familiar with the commodity futures markets. NFA believes strongly that these types of investments, or any other type of investment that is marketed to the retail public as a commodity pool or otherwise as a vehicle for trading or investing in the commodity futures or options markets, should be subject to the protections provided by the CFTC's Part 4 regulations. For example, the offering materials used by these funds omit substantial disclosures that are required by Part 4. Among other things, the offering materials do not provide much information about the managed futures trading program, the fee structures (including a break-even analysis) and the past performance results of the fund's trading managers. The offering materials used by these funds also do not include detailed information about the fund's futures commission merchants and potential conflicts of interest and performance information for the fund or other funds operated by the investment adviser. NFA also strongly believes that these types of funds should be subject to the oversight of the CFTC and NFA who have the experience and expertise in regulating managed retail futures products. Finally, NFA believes that since these funds are effectively offering the same product as a commodity pool, these funds and commodity pools should be subject to consistent regulatory requirements.

NFA's goal in filing the Petition was not to eliminate these mutual fund product offerings. We recognized that simply reinstating the pre-2003 restrictions might

effectively do that. Therefore, when the Commission published its proposed amendments, we assembled an informal group of representatives from commodity pools, representatives from these types of mutual funds, and private counsel who specialize in both the Commission's Part 4 Regulations and the Investment Company Act of 1940. With the help of this group, we developed a somewhat alternative approach, which may address both the CFTC and NFA's regulatory objectives, while at the same time not eliminating the products. In particular, we recommended the following:

- The Commission should consider permitting the registered investment company's (RIC) investment adviser (rather than the RIC) to register as the CPO and list the RIC as a commodity pool with NFA. This eliminates issues regarding whether the RIC's independent directors would have to be listed principals or registered as CPOs themselves.

- The Commission should adopt the five-percent threshold for non-hedge positions in commodity futures, commodity options and swaps positions. Those RICs that exceed this threshold would be required to register as a CPO and be subject to certain Part 4 Requirements, including the proposed requirement to file form CPO-PQR. However, unless the CPO marketed (or should market) the RIC as a vehicle for directly or indirectly trading in commodity futures, commodity options or swap markets, the RIC's CPO would be exempt from certain other Part 4 requirements, particularly relating to the content and use of disclosure documents, monthly account statements and recordkeeping. The CPO would be required to show that it complied with the securities industry's requirements in these areas.

- The Commission should provide more clarity on the application of the "No Marketing Restriction." The adopting release should make clear that a RIC does not trigger the "No Marketing Restriction" simply because its promotional material and/or prospectus either generally mentions that the fund may invest in commodity futures, commodity options or swaps or lists these instruments as a fund's investments. The Commission's release should also make clear, however, that if the fund highlights the benefits or returns of investing futures, or if the fund's name or marketing materials indicate it is a vehicle for investing in (or otherwise seeking investment exposure to) the commodity futures/options/swaps markets, the fund would trigger the "No Marketing Restriction."

- The sole determination of whether a fund is marketed as a commodity pool should not be how it is described in its marketing materials and/or prospectus. The Commission should also make clear in the adopting release, or by amending the language of the "No Marketing Restriction," that the "No Marketing Restriction" applies to a fund that "should be" marketed as a commodity pool and provide guidance on criteria the fund should consider in making this determination, including factors such as:

- Whether futures/options/swaps transactions engaged in by the fund or on behalf of the fund will directly or indirectly be its primary source of potential gains or losses;
- Whether futures/options/swaps trading engaged in by the fund or on behalf of the fund is done through a wholly owned and controlled subsidiary;
- Whether the fund's objective is correlated or tied to a commodity or managed futures index or benchmark;
- Whether the net notional value of the futures/options/swaps positions engaged in by the fund or on behalf of the fund consistently exceeds 100% of the fund's net liquidating value and the extent to which it does so;
- Whether the normal trading activities by the fund or on behalf of the fund result in it having a net short speculative exposure to any commodity through a direct or indirect investment in futures or other derivatives.

- Although we provided these factors, we also stressed that the Commission should not attempt to provide an exact formula, but should place the burden on the CPO to evaluate whether a pool that is a RIC is being appropriately marketed to potential investors in the context of the overall operation of the fund.

- If the RIC could not meet the "No Marketing Restriction," then there would be additional regulatory requirements beyond simply requiring the investment adviser to register as a CPO. The investment advisers for these RICs would be required to comply with all the Commission's Part 4 requirements, including those relating to the content and use of disclosure documents.

- RICs should not be able to avoid Regulation 4.5's operating restrictions by indirectly accessing returns from the commodity futures, commodity options or other derivatives by utilizing commodity linked notes. In order to guard against this, the "No Marketing Restriction" should retain the proposed parenthetical language so that if a person is marketing participations in a RIC to the public as a vehicle for trading in (<u>or otherwise seeking investment exposure to)</u> the commodity futures, commodity options or swaps market, that person would be required to register as a CPO.

- The Commission should consider permitting RICs to use a wholly-owned and controlled subsidiary for futures/options trading provided that the Commission adopt a requirement within Regulation 4.5 whereby the CPO agrees to make the RIC's subsidiary's books and records available for full inspection by the CFTC and NFA.

NFA believes this approach addresses NFA's and the CFTC's regulatory concerns, while at the same time it is not an overly burdensome approach.

Finally, with regard to rescinding the 4.13 exemptions, NFA believes the Commission should reconsider rescinding the 4.14(a)(3) exemption. NFA believes this *de minimis* exemption allows both the Commission and NFA to focus their resources on those entities that are more directly involved in the futures markets and away from investment vehicles that are sold only to sophisticated investors who use futures trading in a limited manner to hedge their risks and diversify their investments. NFA also recommends however that the Commission require that in order to claim this exemption the fund must be regulated by the SEC.