INVESTMENT ADVISER
ASSOCIATION

Summary of Remarks of Alison E. Baur, Deputy General Counsel
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Delivered on Behalf of the Investment Adviser Association, Washington, D.C.

Roundtable on Proposed Amendments to Regulation 4.5 and Proposed Rescission of Regulations 4.13(a)(3) and (a)(4) of the Commodity Futures Trading Commission

July 6, 2011

Good morning, I am Alison Baur, Deputy General Counsel of Franklin Templeton Investments.[1] Thank you for the opportunity to participate in the Roundtable and to present the views of the Investment Adviser Association ("IAA") regarding the proposed amendments to Regulation 4.5 and the proposed rescission of CFTC Regulations 4.13(a)(3) and (a)(4).[2] The IAA represents the interests of SEC-registered investment adviser firms. As you know, IAA members that advise pools exempt under Regulations 4.5, 4.13(a)(3) and (a)(4) are already subject to the full panoply of SEC regulation and oversight. We strongly support effective and appropriate regulation of investment advisers designed to protect investors. However, we believe that duplicative regulation by the CFTC over activities that are already extensively regulated by the SEC is unnecessary, costly and burdensome and does not further investor interests. While we recognize that the CFTC is concerned that it does not have sufficient data regarding commodity pools and that it would like to enhance its information regarding such vehicles, we believe that the CFTC's proposals are not needed to achieve these goals, and that these objectives can be accomplished through an enhanced regulatory reporting approach.

Investment advisers registered with the SEC are subject to comprehensive regulation, including rules that cover reporting, disclosure, custody, effective compliance programs, codes of ethics, advertising, and books and records. Such advisers are required to provide extensive information to the public, to clients, and to the SEC regarding the adviser's business, clients, trading strategies, fees, services, conflicts of interest, and disciplinary history. In addition, SEC registered advisers will very soon be required to provide substantial detailed information about the private funds they manage on Form ADV, which is available to the public. Advisers also will be

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[1] Franklin Resources, Inc. [NYSE:BEN] is a global investment management organization operating as Franklin Templeton Investments. Franklin Templeton Investments provides global and domestic investment management solutions managed by its Franklin, Templeton, Mutual Series, Fiduciary Trust, Darby and Bissett investment teams. The San Mateo, CA-based company has more than 60 years of investment experience and over $735 billion in assets under management as of May 31, 2011. For more information, please visit franklintempleton.com.

[2] The IAA is a not-for-profit association that represents the interests of investment adviser firms registered with the Securities and Exchange Commission ("SEC"). Founded in 1937, the IAA's membership consists of more than 500 firms that collectively manage in excess of $10 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations. For more information, please visit our web site: www.investmentadviser.org.

required to provide information that the CFTC seeks on Form PF, which we understand the SEC intends to share with the CFTC.

Further, under the current regulatory framework, the operators and advisers of funds that trade commodity interests are subject to antifraud provisions under the securities laws as well as the antifraud proscription in Section 4o of the Commodity Exchange Act ("CEA"). The operators, advisers and funds themselves are subject to the proscription on manipulation in Section 9 of the CEA, as well as the large trader reporting and position limit regulations applicable to all traders in the market. When the CFTC adopts the regulations necessary to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), the swap activities of the funds and their operators and advisers will also be subject to the new regulatory framework, which will include (i) extensive reporting requirements for each swap transaction; (ii) new quarterly and annual reporting requirements to regulators on Form PF; (iii) margin requirements imposed by clearing organizations and trading facilities for cleared swaps; and (iv) requirements that swap dealers and major swap participants collect margin on uncleared swaps from counterparties. Finally, the CFTC already knows the entities being operated in accordance with the regulations proposed to be repealed through the exemption notice system administered by National Futures Association ("NFA"), which the CFTC has proposed to enhance.

Therefore, we firmly believe that the existing framework for pools operated in accordance with CFTC exemptions, in combination with the new requirements of Dodd-Frank, will provide the CFTC with the tools necessary to police the commodity interest markets, detect fraud and deter manipulation, all goals that the IAA strongly supports. To the extent that the CFTC believes it needs additional information to enable it to understand and manage systemic risk, we believe that this can be accomplished through enhanced reporting obligations. Under this approach, SEC-registered operators of commodity pools would be required to provide robust data reporting to the CFTC, but regulation governing relations with investors, such as that concerning disclosure, custody, and advertising, would be handled under the current comprehensive and extensive regulatory regime overseen by the SEC. We believe that this approach would address the CFTC's concerns and would avoid redundant and conflicting regulations.[3]

If the CFTC nevertheless determines to rescind Regulation 4.13(a)(3) and (4), the CFTC should exempt SEC-registered advisers that provide advice on commodity interests to private funds for bona fide hedging or for risk management purposes. Such an exemption would be consistent with the CFTC's proposals to amend Regulation 4.5 as well as Dodd-Frank's criteria for classifying a person as a major swap participant, for example. Further, the CFTC should consider a *de minimis* standard for private funds, with potentially separate thresholds for different types of instruments, such as futures and swaps. To the extent a *de minimis* standard would be based upon the level of swap margin requirements, these requirements have yet to be finalized, which argues for deferring any changes to Regulation 4.13 (a)(3) and (a)(4). These steps would ensure

[3] This approach is also consistent with the "exempt reporting adviser" rules that the SEC is implementing pursuant to the Dodd-Frank Act. Such advisers are exempt from SEC substantive regulation, but required to submit much of the same information as registered advisers to "meaningfully identify significant risks to an exempt reporting adviser's clients, investors, or other market participants." SEC Rel. No. IA-3221 (June 22, 2011) at 47.

that the CFTC focuses more appropriately on pools of most interest from a systemic risk perspective.

Further, if the CFTC proceeds with its proposal, it should (1) provide an exception for operators of funds-of-funds; (2) provide an exception for operators of funds with limited or no participation by U.S. investors, and (3) make clear who must register as a commodity pool operator ("CPO") (for a pool formed as a corporation or similar entity, the investment adviser is the most logical person). If the CFTC determines to require regulation in addition to reporting, it should work with the SEC to harmonize requirements for disclosure and reporting to investors, such as whether past performance of other pools will be required, which may violate FINRA rules for funds distributed by broker-dealers.

With respect to the proposed amendments to Regulation 4.5, the IAA did not submit separate written comments but supported the comments submitted by the Investment Company Institute. I would like to highlight a few additional points specific to this issue.

Consistent with my discussion relating to the robust regulatory regime for SEC-registered advisers to private funds, registered investment companies ("RICs") are also subject to comprehensive regulation by the SEC. Under the Investment Company Act of 1940, RICs (i) must provide extensive and detailed disclosure about their activities; (ii) are limited in their use of leverage; (iii) are subject to public reporting regarding their holdings and other activities; (iv) must follow rules related to promoting diversification and limiting concentration; and (v) are required to have a comprehensive compliance program. In addition, the Dodd-Frank requirements discussed above will provide more detailed information relating to a RIC's swap activities. While additional reporting of a RIC's activities may be desirable for the CFTC to enhance its ability to monitor systemic risk, the current regulatory regime under the Investment Company Act already provides comprehensive investor protection standards. Additional substantive regulation by the CFTC of a RIC's activities would be burdensome, disruptive and counter-productive to the aim of protecting investors. Accordingly, while we support the CFTC's objective of effective regulatory monitoring, we believe that these goals can be met through enhanced reporting and would not be met by a duplicative and inconsistent regulatory regime.

You will hear from many other participants today regarding additional reasons why it would be ill-advised to proceed with the proposed amendments to Rule 4.5 and various related considerations. Accordingly, I will take this opportunity to note other concerns with proposed CFTC rules relating to real-time public reporting of swap trades, including non-deliverable currency forwards, and requirements to obtain multiple broker quotes before swap trades can be executed, as having the potential to compromise sensitive trading data, thereby having the unintended consequence of impacting the efficiency and liquidity of these markets.

We urge the CFTC to allow the new Dodd-Frank rules to take effect and review the new information and reporting that the CFTC will receive under the new rules, which we believe would address the CFTC's regulatory monitoring concerns.

I would be pleased to answer any questions you may have regarding my remarks, the IAA's comments, or the effect of the proposals on SEC-registered investment advisers.