OppenheimerFunds

# Presentation to CFTC Staff
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# Mutual Fund Structure

**Fund Directors/Trustees**
Provide oversight only. Majority are independent of Adviser, with separate legal counsel.

**Investment Adviser**
Investment management/ administrative services

**MUTUAL FUND**
Corporation or Trust with no employees but Chief Compliance Officer

**Investing Public**
**(Mutual Fund Shareholders)**



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# Key Structural Limitations in the Operation of Mutual Funds

- Mutual Funds are heavily regulated investment vehicles in the U.S. Unlike other securities laws, the Investment Company Act places substantive restriction on mutual funds and advisers, including:
  - Extensive disclosure, advertising, reporting and record keeping requirements;
  - Restrictions on the ability to create risk through leverage (including through borrowing and embedded leverage of derivatives);
  - Daily redemptions and pricing
  - Prohibitions on tiered structures and preferred classes of shares;
  - Investment concentration limits (both under the 1940 Act and the Internal Revenue Code);
  - Strict rules on conflicts of interest (e.g., transactions with affiliates);
  - Safekeeping of assets; and
  - Strong anti-fraud safeguards.

# Tax Requirements

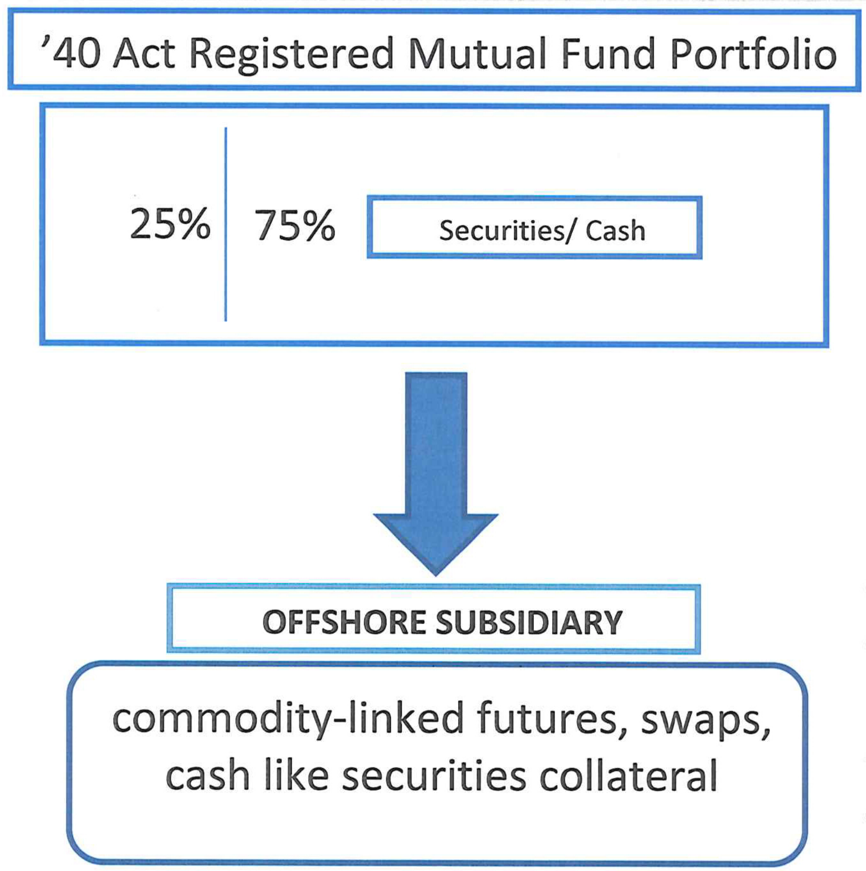
- Mutual Funds benefit from favorable tax treatment – "dividends paid deduction"

- Tax qualification of fund depends on compliance with Section 851 asset and income tests under IRS Code:

- <u>Asset diversification tests</u>:
  - 50% must be cash and securities with single issuer limits; no more than 25% from a single issuer

- <u>Income Tests</u>:
  - 90% of Income must be derived from business of investing in securities ("qualifying income sources")
  - Commodity investments create non-qualifying income for mutual funds

# Fund With Offshore Subsidiary Structure




Mutual Fund can invest no more than 25% of assets in shares of wholly-owned offshore subsidiary

- Wholly owned;
- Corporation, "qualifying income" for tax;
- Fund insulated from liability;
- SEC looks through offshore subsidiary for '40 Act compliance and disclosure (including limitations on leverage)

# Offshore Subsidiaries

- Fund portfolio management has become more sophisticated, including use of financial derivatives to control interest rate, credit, currency and duration exposures.
- IRS has held that "commodity linked derivatives" create non-qualifying income for mutual funds; but has issued private letter rulings stating that shares of a wholly-owned subsidiary corporation that hold such derivatives generate qualifying income (because the shares are "securities").
- Mutual funds therefore use offshore subsidiaries to manage "non-qualifying income" associated with the use of certain financial derivatives.
- Wholly-owned because of investment company issues; offshore to avoid double taxation.
- Offshore subsidiaries:
  - Are generally looked through for '40 Act compliance
  - Provide liability protection to fund shareholders