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September 15, 2011

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

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant" (CFTC: RIN 3235-AK65; SEC: File No. S7–39–10)[1]

Dear Mr. Stawick and Ms. Murphy:

The Asset Management Group (the "**AMG**") of the Securities Industry and Financial Markets Association ("**SIFMA**") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "**CFTC**") and the Securities and Exchange Commission (the "**SEC**" and, together, the "**Commissions**") with our comments on the Notice of Proposed Rulemaking (the "**NPR**") further defining, among other terms, the term "eligible contract participant" ("**ECP**") specifically with regard to the proposed application of the ECP definition in CFTC Rule 1.3 to commodity pools.

The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, state and local government pension funds, universities, 401(k) or similar types of retirement funds, and private funds such as hedge funds and private equity funds. In their role as asset managers, AMG member firms, on behalf of their clients, may engage in transactions that will be classified as swaps under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**") and transactions to which the Commissions' proposed ECP definition would apply.

The AMG respectfully submits that clause (5) of proposed Rule 1.3(m), if adopted, would prove not only burdensome, but would also cause undue harm and be unworkable, in large part, because of the informational requirements that must be obtained from 2nd, 3rd and 4th (*etc.*) tier investing funds with whom a transacting commodity pool and its counterparty have no relationship. Additionally, clause (6) of proposed Rule 1.3(m), if adopted, would cause undue

[1] 75 Fed. Reg. 80174 (Dec. 21, 2010) ("Joint Definitions Proposal").

harm by limiting the ability of certain commodity pools to engage in over-the-counter swap transactions in circumstances where there is no evidence that Congress intended such a limitation and no empirical evidence of abuses necessitating such limitations. The significance of this result is accentuated by the large numbers of collective investment vehicles that utilize over-the-counter foreign exchange ("**Fx**") transactions for incidental investment purposes. The AMG further submits that the Commissions' proposed approach is not necessary to achieve the investor protection objectives of Dodd-Frank, particularly in circumstances where the relevant transactions would, but for the Commissions' proposed rules, be subject to, and conducted in accordance with, Dodd-Frank's regulatory framework for swaps.

BACKGROUND

Sections 2(c)(2)(B) and 2(c)(2)(C) of the Commodity Exchange Act ("**CEA**") provide the CFTC with jurisdiction over certain over-the-counter Fx transactions entered into by non-ECPs ("**covered Fx transactions**"). Sections 741(b)(8) and (b)(9) of Dodd-Frank amended these provisions of the CEA to provide that the "Act applies to, and the Commission [CFTC] shall have jurisdiction over, an account or pooled investment vehicle that is offered for the purpose of trading, or that trades, any agreement, contract, or transaction in foreign currency described in clause (i)." Simultaneously, Section 741(b)(10) of Dodd-Frank created an exception to the commodity pool prong of the ECP definition codified in CEA Section 1a(18)(A)(iv) ("**clause (A)(iv)**") with respect to covered Fx transactions, which provides that "for purposes of section 2(c)(2)(B)(vi) and section 2(c)(2)(C)(vii), the term 'eligible contract participant' shall not include a commodity pool in which any participant is not otherwise an eligible contract participant". The result is that any commodity pool with non-ECP investors will be subject to the statutory and regulatory retail Fx requirements, unless it qualifies as an ECP under another prong of the ECP definition (*i.e.*, other than under clause (A)(iv)).

In the Joint Definitions Proposal, the Commissions propose to expand the exception from the ECP definition beyond that adopted by Congress to include commodity pools whose investors have direct or indirect non-ECP participants. The Commissions, in articulating how they propose to approach commodity pools with non-ECP investors, state:

> Because commodity pools can be structured in various ways and can have one or more feeder funds and/or pools, many with their own participants, the Commissions propose to preclude a Retail Forex Pool from being an ECP pursuant to clause (A)(iv) of the ECP definition if there is a non-ECP participant at any investment level (e.g., a participant in the pool itself (a direct participant), an investor or participant in a fund or pool that invests in the pool in question (an indirect participant), an investor or participant in a fund or pool that invests in that investor fund or pool (also an indirect participant), etc.).[2]

As a result, a commodity pool engaging in covered Fx transactions that is itself an ECP for all other purposes under the CEA and CFTC regulations would cease to be an ECP if it has a single

[2] Joint Definitions Proposal, supra note 1, at 80185.

non-ECP investor. If that fund, in turn, invested in another fund that was otherwise an ECP, that investee fund would also cease to be an ECP, ad infinitum.[3]

With respect to covered Fx transactions specifically, the text of the NPR indicates that the Commissions would restrict clause (A)(v) of the ECP definition "to preclude a Retail Forex Pool with one or more direct or indirect non-ECP participants from qualifying as an ECP by relying on clause (A)(v) of the ECP definition if such Retail Forex Pool is not an ECP due to the language added to clause (A)(iv) of the ECP definition by section 741(b)(10) of the Dodd-Frank Act (*i.e.*, because the pool contains one or more non-ECP participants)."[4] However, the proposed text of Rule 1.3(m)(5) is not precise in codifying this intent.

The Commissions also propose to exclude a commodity pool that would be a non-ECP pursuant to clause (A)(iv) from qualification as an ECP under CEA Section 1a(18)(A)(v) ("**clause (A)(v)**"). In order to qualify as an ECP under clause (A)(iv), a commodity pool would be required to (i) have total assets exceeding $5,000,000 and (ii) be formed and operated by a person subject to regulation under the CEA or a foreign equivalent and have only ECP investors. In contrast, any business organization or other entity, whether or not a commodity pool, may qualify as an ECP under clause (A)(v) if it (i) has total assets exceeding $10,000,000[5] or (ii) has a net worth exceeding $1,000,000 and enters into the transaction in connection with the conduct of its business or to manage the risk associated with an asset or liability owned or incurred or reasonably likely to be owned or incurred by the entity in the conduct of its business.

Proposed Rule 1.3(m)(6) provides that a commodity pool that does not have assets exceeding $5,000,000 or is not operated by a person subject to regulation under the CEA or a foreign equivalent would not qualify as an ECP pursuant to clause (A)(v). Notably, this limitation on a commodity pool's ability to qualify as an ECP under clause (A)(v) would apply for all purposes and not merely for the purposes of covered Fx transactions.

DISCUSSION

1. Proposed Rule 1.3(m)(5)–Analysis

Dodd-Frank limits ECPs under clause (A)(iv) (for purposes of covered Fx transactions) to commodity pools that have only ECP investors, unless such pools qualify under another prong of the ECP definition, such as the prong for plans subject to the Employee Retirement Income and Security Act of 1974 ("**ERISA**") or SEC-registered investment companies, among others.[6] However, in contrast to the Commissions' proposed ECP definitional amendments, Dodd-Frank

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[3] See CFTC Rule 1.3(m)(5). We refer herein to this as the "**ECP Look-through.**"

[4] Joint Definitions Proposal, supra note 1, at 80185. This would prevent even a commodity pool with assets exceeding $10,000,000 from relying on CEA 1a(18)(A)(v) to qualify as an ECP for purposes of covered Fx transactions if it has direct or indirect non-ECP investors.

[5] An entity would also qualify as an ECP under this prong if its obligations are guaranteed—under an agreement or contract—by an entity that is an ECP.

[6] As the Commissions recognize, under the ECP definition as codified, a person that fails to qualify under one prong of the ECP definition may nonetheless qualify under another prong of the definition.

only requires that the ECP status of a transacting commodity pool be determined by the ECP status of its direct investors, and not by reference to the ECP status of every commodity pool or fund indirectly investing in the transacting commodity pool.

We are sympathetic to the Commission's implicit objective: to ensure that a person that would not qualify as an ECP is not permitted to accomplish indirectly what it is not permitted to do directly. However, apart from statutory provisions authorizing the Commissions to address evasion, we see no evidence in Dodd-Frank or its legislative history that Congress intended or authorized the Commissions to expand the limitations on clause (A)(iv) commodity pool ECPs in the manner they have proposed to adopt under the NPR.

The prevention of evasion does not require the expansive limitations proposed by the Commissions through application of the ECP Look-through. We acknowledge that, in order to prevent evasion, some form of the ECP Look-through would be appropriate in cases where circumvention could otherwise occur. However, we do not believe that any such Look-through would be necessary or appropriate unless both the transacting pool and the investing pool are formed for the purpose of providing retail investor access to covered Fx transactions.

On a practical level, the additional burdens that commodity pools—and, indirectly, their investors—would face with respect to covered Fx transactions could cause undue harm. As described in the cost-benefit discussion of the NPR, the Commissions are of the view that the proposed ECP definition would "impose virtually no costs" but would provide "greater certainty".[7] We believe the Commissions are misguided in reaching both of these conclusions and do not fully appreciate the practical challenges that are presented by the Joint Definitions Proposal.

An unrestricted application of the ECP Look-through would not only be operationally burdensome, but, as a practical matter, unworkable. Very few, if any, pools have the ability to identify the status of every investor in each of the funds that invests in it, directly or indirectly, particularly funds with whom it has no direct relationship. No pool currently in existence has the subscription documentation and monitoring capability that would enable it to make the requisite determinations or to ensure that the fund meets the required investor qualifications. Moreover, ongoing, real-time monitoring would be required at all investment levels as funds take on new investors or as old investors withdraw or cease to qualify as ECPs. This would require systems and processes that funds do not currently have in place and that would be difficult, time consuming and expensive to implement.

Requiring pools to take the steps necessary to comply with the proposed unrestricted ECP Look-through would not only inject considerable uncertainty into a process that currently benefits from clarity, but would also create significant operational and compliance costs to the extent compliance with the requirement could be accomplished prospectively. This problem is compounded by the fact that contracting parties must know whether the covered Fx transaction regime is applicable to a transaction, as the rules applicable to that regime vary significantly from the swap rules. If a fund incorrectly assumes that an Fx transaction is governed by the

[7] Joint Definitions Proposal, supra note 1, at 80203.

covered Fx transaction regime (or by the swap rules), non-compliance and potentially significant liabilities could result.

Finally, the potential costs of the Commissions' proposed ECP Look-through are not limited to the operational costs of determining the status of all investors at each level of investment and having systems in place to monitor that status on an ongoing basis. Transactions between commodity pools that either have indirect non-ECP investors or cannot determine that they do not have such investors and entities that are not permitted to conduct covered Fx transactions (*e.g.*, certain foreign affiliates of U.S. banks, broker-dealers or FCMs) would likely have to be re-booked, often at a substantial cost. Funds that would not qualify as ECPs or face uncertainty with respect to their status may choose not to engage in covered Fx transactions for hedging purposes, resulting in greater risk to funds and their investors, including funds and investors who may wish to engage in covered Fx transactions other than for purely speculative purposes.

Funds may be deterred from transacting under the covered Fx transaction regime as a result of concerns regarding capital requirements that differ from the institutional over-the-counter Fx market, less liquidity than exists in the institutional over-the-counter Fx market, and concerns that a change in investor status may require future Fx transactions to be executed with other counterparties, necessitating the potentially time-consuming and costly rebooking of transactions (where that can be arranged).

Given these considerations, we believe that Dodd-Frank's policy objectives are not furthered by a blanket and unrestricted application of the Commissions' proposed ECP Look-through and that the Commissions should not go further in their rulemaking than is necessary to faithfully implement the changes made by Congress to clause (A)(iv), or, at the very most, to prevent evasion.

2. Proposed Rule 1.3(m)(5)–Recommendations

Indirect Non-ECP Investors

Based on the foregoing considerations, we urge the Commissions to modify and clarify proposed Rule 1.3(m)(5) in certain respects. First and foremost, we believe that the proposed Rule 1.3(m)(5) changes should apply solely to the Congressional language added to clause (A)(iv) under Dodd-Frank. Going beyond this exceeds the Congressional intent underlying Section 741(b)(10) of Dodd-Frank and implies that Congress was not cognizant of the other clauses of the ECP definition. There is no evidence to support such a conclusion.

If, however, the Commissions determine that applying Rule 1.3(m)(5) solely to the clause (A)(iv) changes is not sufficient to address potential evasion concerns, they should apply Rule 1.3(m)(5) in a manner that is not unduly expansive and burdensome. In such case, we recommend that the Commissions modify Rule 1.3(m)(5) to clarify that (i) a commodity pool with non-ECP investors is only ineligible as an ECP (for purposes of covered Fx transactions) under clauses (A)(iv) and (A)(v)(III) of the ECP definition, and not under any other prong of the ECP definition for which it may otherwise be eligible; and (ii) the ECP status of indirect investors in a commodity pool is only required in circumstances where (a) the direct investor

does not qualify as an ECP under another prong of the ECP definition (other than clause (A)(iv)) or (b) the transacting pool is formed for the specific purpose of entering into covered Fx transactions.

Non-commodity pool investors. We note that, as drafted, proposed Rule 1.3(m)(5) goes further than Congress provided or intended under clause (A)(iv) in another respect. Specifically, the ECP Look-through is not drafted in a manner that would be limited to indirect investors in commodity pools that invest in the transacting commodity pool. Instead, the Joint Definitions Proposal purports to extend the ECP Look-through to any indirect investors. Ultimately, every corporation, plan, trust or collective investment vehicle has direct or indirect natural person investors who will not be ECPs. Virtually every fund could be captured as a result.

We do not believe it would be logical for the Commissions to take the position that Congress would expressly permit a corporation, investment company or ERISA plan to qualify as an ECP regardless of the fact that its investors include non-ECPs, but look through that corporation, investment company or ERISA plan to its non-ECP investors for the purpose of determining whether a commodity pool in which it is invested qualifies as an ECP. We assume that the Commissions did not intend this result. Accordingly, we recommend that, to the extent the ECP Look-through is applicable, it would only look to those indirect investors who invest in commodity pools (other than commodity pools that qualify as ECPs under a prong of the ECP definition other than clause (A)(iv)).

Formed for the specific purpose of entering into covered Fx transactions. In order to implement the concept of "formed for the specific purpose of entering into covered Fx transactions" in a manner that provides the necessary certainty for affected parties under clauses (A)(iv) and (A)(v)(III), we recommend that the Commissions adopt a safe harbor outlining those non-exclusive circumstances in which a commodity pool would be deemed not to have been formed for the purpose of entering into covered Fx transactions.[8] We recommend that the safe harbor include, at least, the following circumstances:

1. Less than 25% of the equity capital contributed to the fund is contributed by non-ECPs;[9] or

2. The fund engages in covered Fx transactions solely for hedging or risk management purposes or to extinguish or offset an existing covered Fx transaction or other Fx exposures; or

3. The fund engages in covered Fx transactions (other than for hedging or risk management purposes or to extinguish or offset an existing covered Fx transaction or other Fx exposure):

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[8] In the case of a fund whose circumstances are not enumerated in the safe harbor, interested persons could seek confirmation from the CFTC that the relevant fund is not formed for the purpose of entering into covered Fx transactions.

[9] We note that this prong would be consistent with the application of ERISA to Investment Funds. Subject to certain exceptions, an Investment Fund becomes subject to ERISA in circumstances where 25 percent or more of any class of equity securities of the Fund is held by benefit plan investors. See 29 C.F.R. § 2510.3-101(f).

- solely for portfolio diversification purposes as part of an asset allocation strategy; and

- no more than 25% of the fund's aggregate notional investment exposure is to covered Fx transactions.

Transition Relief

We also recommend that the Commissions adopt a transition rule that would grandfather commodity pools in existence prior to the adoption of final rules. We believe such a transition rule would be critical because existing funds have not captured information regarding the ECP status of their investors, although they have in many cases obtained information regarding the qualified eligible participant, accredited investor and/or qualified purchaser status of their investors. As a result, many funds have not drafted transfer restrictions or monitoring provisions that address ECP status and may not have the contractual right to retrospectively expand transfer restrictions applicable to fund investors. Based on these concerns, we recommend that the Commissions adopt a transition rule for any commodity pool in existence prior to the effective date of the Commissions' implementing rules that would grandfather such commodity pools as ECPs in connection with covered Fx transactions in circumstances where each direct investor in the pool is an eligible contract participant, a qualified eligible participant, accredited investor or qualified purchaser under applicable SEC and/or CFTC rules.

In the event that the Commissions regard such relief as overly broad, we urge the Commissions to consider further limiting the transitional relief to commodity pools that, in addition to satisfying these criteria, also satisfy the criteria enumerated in either of clause (2) or clause (3) in the preceding sub-section entitled "*Formed for the specific purpose of entering into covered Fx transactions*."

Such an exemption would contribute significantly in mitigating the increased costs and risks to pools and investors described above in the sub-section entitled "**Proposed Rule 1.3(m)(5)–Analysis**."

Conditional Exemptive Relief

We also recommend that the CFTC use its exemptive authority to exclude from CEA Sections 2(c)(2)(B) and (C) any transaction by a commodity pool that would be an ECP but for the ECP Look-through in circumstances where (i) the pool satisfies either of the criteria enumerated in clause (2) or clause (3) in the preceding sub-section entitled "*Formed for the specific purpose of entering into covered Fx transactions*" and (ii) the transaction is conducted by the contracting parties in compliance with all rules that would be applicable to a swap transaction and the counterparty is a swap dealer registered with the CFTC. Such a step would facilitate legal certainty while ensuring that transactions remain subject to regulation.

Although we have located no legislative history directly on point, we believe such an exemption would be appropriate because Congress likely made the changes to clause (A)(iv) to ensure that investors do not lose the protections of CEA Sections 2(c)(2)(B) and 2(c)(2)(C) as a result of participating in the covered Fx transaction market through a commodity pool, rather

than because it was expressing a preference for the covered Fx transaction rules over the more comprehensive swap rules.

Reliance on Representations

Finally, as noted above, we recommend that the Commission clarify, consistent with prevailing financial market practice, that the operator or manager of, or counterparty to,[10] a commodity pool may reasonably rely on the representations of commodity pool investors regarding their status as ECPs.

3. Proposed Rule 1.3(m)(6)–Analysis

Under proposed Rule 1.3(m)(6), the Commissions would limit the eligibility of commodity pools under clause (A)(v) of the ECP definition so as to exclude any commodity pool that does not qualify as an ECP under clause (A)(iv) as a result of the failure to satisfy both the $5 million net asset test and regulated person requirements. We understand the Commissions' concern that, as drafted, certain commodity pools that would not qualify under clause (A)(iv) could qualify under clause (A)(v) and, in particular, clause (A)(v)(III), without any additional mitigating considerations.

At the same time, we note that Congress did not amend the statute to prevent commodity pools from qualifying as ECPs under clause (A)(v) (and evidenced no intent to do so) and we are not aware of problems that have arisen from commodity pool reliance on clause (A)(v) generally or clause (A)(v)(III), in particular, of the ECP definition.[11] Even though the quantitative standard in clause (A)(v)(III) is lower than that in clauses (A)(iv) and (A)(v)(I), it is not surprising that commodity pool reliance on clause (A)(v)(III) has not given rise to problems in light of clause (A)(v)(III)'s line of business/risk management requirement. As a result, we do not believe that the modifications contemplated by proposed Rule 1.3(m)(6) are warranted, particularly in light of the changes in proposed Rule 1.3(m)(5).

If the Commissions nonetheless determine to impose further limitations under clause (A)(v) with respect to commodity pools, the Commissions should take steps to avoid an unduly broad limitation and adopt a narrower exclusion that would apply only to ECP status for purposes of the covered Fx regime and that would only apply to part (III) of clause (A)(v) under the circumstances set forth below.

4. Proposed Rule 1.3(m)(6)–Recommendations

We recommend that the Commissions withdraw proposed Rule 1.3(m)(6). In the event that the Commissions do not withdraw proposed Rule 1.3(m)(6) as we have recommended, we

[10] Counterparties proposing to enter into transactions with commodity pools would have particular difficulty determining whether a commodity pool must be treated as a retail investor, making it all the more critical that they be permitted to rely on their counterparty's representations as to its ECP status.

[11] The fact that Congress did not amend clause (A)(v) is particularly strong evidence that it did not intend to prevent commodity pools from relying on this prong of the ECP definition, since the Dodd-Frank amendments to clause (A)(iv) relate only to covered Fx transactions.

suggest that the Commissions modify proposed rule 1.3(m)(6) so that (i) it only applies to ECP status with respect to CEA Sections 2(c)(2)(B) and (C), and (ii) it would only apply to a commodity pool that does not satisfy one or more of the following criteria:

1. The commodity pool is a private investment fund (including any fund satisfying the requirements of Investment Company Act of 1940 Rules 3(c)(1), (7) or (11)) whose transactions are effected under the management of an SEC-registered investment adviser, CFTC-registered commodity trading advisor or bank as defined in Section 202(a)(2) of the Investment Advisers Act of 1940; or

2. The commodity pool satisfies part (I) or (II) of clause (A)(v) (*i.e.*, is a business organization or other entity that has total assets exceeding $10,000,000 or has its obligations guaranteed under contract, letter of credit or other agreement by an entity with total assets greater than $10,000,000 or that qualifies as an ECP under another prong of the definition); or

3. The commodity pool is excluded from the definition of commodity pool under CFTC Rule 4.5, or its "operator" is eligible for exemption from commodity pool operator registration under CFTC Rule 4.5 or CFTC Rule 4.13.

Additionally, consistent with the ECP definition itself and our comments above with respect to proposed Rule 1.3(m)(5), and for the avoidance of any uncertainty or confusion arising from the Commissions' actions, the Commissions should clarify that a commodity pool that does not satisfy the requirements of clause (A)(iv) or (A)(v) (for any reason), but that does satisfy the requirements of any other prong of the ECP definition would continue to qualify, as it does currently, as an ECP for all purposes.

CONCLUSION

We believe the clarifications and modifications recommended above appropriately balance Congressional intent as evidenced in the statutory ECP definition and the Commissions' legitimate interests in preventing circumvention of fundamental protections contemplated by Congress. We believe these recommendations will provide appropriate protections, where needed, for market participants in need of such protections, while at the same time promoting a cost-effective regulatory framework that will not unduly burden market participants.

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The AMG thanks the Commissions for the opportunity to comment on the Joint Definitions Proposal and for the Commissions' consideration of the AMG's views. The AMG would welcome the opportunity to further discuss our comments with you. Should you have any questions, please do not hesitate to call the undersigned at 212-313-1389.

Sincerely,

Timothy W. Cameron, Esq.
Managing Director, Asset Management Group
Securities Industry and Financial Markets Association