NFA NATIONAL FUTURES ASSOCIATION

April 24, 2012

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

Re: Regulation 4.5 Harmonization

Dear Mr. Stawick:

National Futures Association (NFA) appreciates the opportunity to comment on the Commodity Futures Trading Commission's (CFTC or Commission) proposed amendments to Part 4, which are designed to facilitate compliance with the Commission's disclosure, reporting and recordkeeping requirements by certain commodity pool operators (CPOs). These CPOs are Investment Advisers (IAs) who advise registered investment companies (RICs) that can no longer claim an exclusion from CPO registration due to the recent amendments to Commission Regulation 4.5.

At the outset, NFA again wishes to stress the importance of the CFTC's and Securities and Exchange Commission's (SEC) efforts to harmonize their regulatory requirements so that these RICs can operate under a dual regulatory structure. As stated in NFA's April 12, 2011 comment letter to the CFTC regarding this same issue:

> The Commission's proposal also asks for specific comments identifying CFTC and SEC requirements regarding the operation of these funds under a dual regulatory structure that conflict, as well as the best way to address these conflicts. In NFA's view, this question is extremely important because as we stated in our October 18, 2010 comment letter, NFA's August 2010 Petition did not seek to eliminate these RIC product offerings. To that end, we specifically encouraged the Commission to not only provide adequate time for CPOs offering these RICs as pools to comply with the Commission's applicable regulations if certain operating restrictions are re-imposed but more importantly consider as part of any proposed rulemaking what, if any, relief may be appropriate for CPOs offering these RICs as pools subject to the CFTC's jurisdiction.

As you are aware, NFA's April 12, 2011 comment letter describes in detail proposed amendments to Part 4 of the Commission's regulations in the areas of pool disclosure, reporting and recordkeeping to facilitate the operation of these pools. To the extent that the Commission has now proposed amendments to its regulations that NFA previously outlined in its 2011 comment letter, NFA fully supports those proposed changes. In particular, NFA commends the Commission for proposing to extend relief similar to the relief recently granted to commodity exchange-traded funds (commodity ETFs), which goes a long way towards harmonizing conflicting CFTC and SEC requirements. NFA also supports the Commission's proposal to extend this relief to all publicly offered pools regardless of whether their units are listed for trading on a national securities exchange.

In order to fully respond to the Commission's request for comment on its proposed changes, as well as other possible areas of harmonization, NFA reassembled its informal group of representatives from public commodity pools, those who currently operate commodity-related RICs and private counsel who specialize in the Commission's Part 4 Regulations and/or the Investment Company Act of 1940 ('40 Act). This group provided NFA with valuable input in formulating NFA's 2011 harmonization recommendations and once again proved invaluable in helping NFA formulate the recommendations discussed below.

Registration Requirements

NFA requests that the Commission provide additional clarity regarding the entity that must either register as a CPO because it offers a RIC that does not meet the operating restrictions or claim an exclusion from the CPO definition (and thus not have to register) because it operates a qualifying RIC. While this lack of clarity appears wholly inadvertent, several entities contemplating filing for 4.5 exclusions have recently contacted NFA to raise this issue.

Specifically, Commission Regulation 4.5(a)(1) currently provides that a RIC that operates a qualifying RIC is excluded from the definition of CPO and is therefore not required to register. Presumably, any RIC that does not meet the requirements of a qualifying entity under Regulation 4.5 is required to register as a CPO. In the preamble to the February 2012 Federal Register notice of the final rule amendments, however, the Commission indicates that the RIC's IA is the appropriate entity to register as the CPO.[1] NFA's acknowledges that its April 2011 comment letter fully supported allowing the RIC's IA to be permitted to register as the CPO. Yet, NFA

[1] *See* 77 FR 11252 at 11259.

does not believe that this registration position will be readily apparent from reviewing the Commission's regulations. It also appears to have a collateral impact of causing confusion as to whether a RIC (through its governing board) or the IA for the RIC should be filing for an exclusion under Regulation 4.5(a)(1).

Therefore, NFA recommends that the Commission address this issue by issuing formal interpretive guidance that interprets Regulation 4.5(a)(1) to provide that either a RIC or its IA is eligible to claim an exclusion under Regulation 4.5 for a qualifying RIC. Moreover, NFA suggests that this interpretive guidance also clarify that, for those RICs that do not qualify for the CPO exclusion because they do not meet the operating restrictions, either the RIC's IA or RIC may register as the CPO.

Lastly, in the registration area, NFA also requests that the Commission clarify either via formal guidance or in the Federal Register that adopts the harmonization requirements that an individual who solicits investments in these funds will not have to register as an associated person (AP) if the person meets the requirements of Regulation 3.12(h)(ii)'s exemption from AP registration.

Content of Disclosure Document/Prospectus

As the Commission notes in its proposed rulemaking, the SEC's prospectus content and the CFTC's disclosure document content requirements differ or conflict in a number of areas. The Commission's proposal contemplates addressing these differences as follows:

- CFTC Regulation 4.25(c) requires that when the offered pool has less than a three-year operating history, the CPO must disclose in the pool's disclosure document performance information related to the other pools and accounts as enumerated in Regulation 4.25(c)(2)-(5). Since this requirement may conflict with SEC rules regarding the disclosure of past performance information in a fund's prospectus, the CFTC is proposing to permit this disclosure information to appear in the RIC's Statement of Additional Information (SAI).

- CFTC Regulation 4.24(d) requires the CPO to disclose a number of pieces of information, including the break-even point per unit of initial investment, in the forepart of the pool's disclosure document. The CFTC is proposing to permit this information to be disclosed in the section immediately following all disclosures required by SEC Form N-1A to be included in the summary prospectus or otherwise for RICs using Form N-2 in the forepart of the prospectus.

- CFTC Regulation 4.24(i) requires that the disclosure document include a complete description of each fee, commission and other expense incurred by the pool for its preceding fiscal year and expected to be incurred by the pool in its current fiscal year. The CPO must also include a tabular presentation of the calculation of the pool's break-even point. The CFTC is proposing that any fees and expenses required to be disclosed by CFTC Regulation 4.24(i) that are not included in the fee table required by Item 3 of Form N-1A or Form N-2 may be disclosed in the prospectus along with the tabular presentation of the calculation of the pool's break-even point.

The Commission's willingness to compromise on the placement of this information in a disclosure document will clearly make it easier for pools that are RICs to comply with CFTC and SEC content requirements. NFA is concerned, however, that the SEC may not permit pools to include this information in either the prospectus or SAI. Therefore, NFA encourages the CFTC to continue working with the SEC on these disclosure issues and obtain its affirmative support for making these disclosures as proposed. NFA's 4.5 Working Group also thought it might be beneficial for the CFTC and SEC to jointly develop a statement that details how to address these disclosure issues and ideally develop a model prospectus that would be satisfactory to both the CFTC and SEC.

NFA also notes that in the Commission's proposing release, it indicates that it has had preliminary discussions with the SEC staff on the issue of including CFTC required performance disclosures enumerated in 4.25(c)(2)-(5)(which may conflict with SEC requirements) and that SEC staff stated that it would consider requests for no-action relief. Since it appears that this no-action relief will be necessary for any RIC to be able to include the CFTC required past performance disclosures under SEC requirements, NFA believes that it is essential that the SEC issue this no-action relief. Moreover, NFA recommends the CFTC encourage the SEC to provide a "global" no-action relief that would apply to any RICs that are also under CFTC jurisdiction, rather than on a case-by-case basis.

Controlled Foreign Corporation

The Commission indicated in its February 2012 Federal Register release setting forth the final amendments to Regulation 4.5 that it did not oppose the continued use of controlled foreign corporations (CFCs) by RICs. As the Commission notes, RICs may invest up to 25% of their assets in a CFC through which they then engage in actively managed derivatives strategies. As noted in our April 2011 comment letter, NFA agrees that RICs should be permitted to use CFCs under the appropriate

circumstances, including full disclosure of the CFC's activities and full accessibility to its books and records.

Under the Commission's regulations, a CFC constitutes a major investee pool. As a result, the RIC's disclosure document would have to include certain disclosures regarding the CFC as outlined in Regulation 4.24, including information on the CPO of the CFC and a summary description of the CFC, including the types of interests traded by the CFC, material information on volatility, leverage and rates of return. Although NFA agrees that these disclosures are important and provide a prospective participant with important information, NFA further believes that in certain situations additional disclosures may be necessary. In particular, for many of these RICs, the CFC is the only fund that the RIC invests in and is the pool/RIC's only source of derivatives exposure (or any material investment exposure). This relationship is significantly different than a typical fund-of-funds structure, and NFA recommends that the Commission clarify in its final rulemaking that the RIC's disclosure document must contain a full discussion of this relationship and its impact upon the pool/RIC. For example, pool participants should know that the pool/RIC's return is primarily if not solely tied to the performance of the CFC.

Past Performance Information on Other Funds and Accounts

CFTC Regulation 4.25(c)(2) requires that if an offered pool, as described, has less than 3 years of operating history, then the pool's disclosure document must include performance information related to other pools operated by the CPO. NFA certainly recognizes the importance and relevance of this information for a participant to make an informed investment decision.

However, in the context of IAs registering as CPOs because they advise a pool/RIC that does not meet Regulation 4.5(c)'s operating criteria, NFA believes that further clarity may be helpful as to what constitutes a "pool" for purposes of reporting other past performance information. Specifically, large IAs may advise pools registered under the '40 Act but also advise RICs that are not pools because they do not trade in commodity futures or commodity options contracts or swaps or are excluded from the definition of CPO pursuant to Regulation 4.5(a)(1). Therefore, to alleviate anticipated confusion as to the reporting of past performance information for other "pools", NFA recommends that the Commission consider clarifying the scope of this disclosure. Specifically, NFA suggests that that the Commission require a CPO advising a pool registered under the '40 Act to only disclose past performance information pursuant to Regulation 4.25(c)(2) for other commodity pools listed with NFA by the CPO/IA.

Monthly Account Statements

Under Commission Regulation 4.22(a), most commodity pools are required to provide a monthly account statement to the pool's participants. As the Commission noted in the proposed harmonization release, the SEC does not require RICs to distribute monthly account statements. As noted in NFA's April 2011 comment letter, however, since RICs are sold through a principal underwriter that is a registered broker-dealer, the broker-dealer is required to provide a quarterly account statement to its customers under FINRA Rule 2340. Although the Commission acknowledges this timing difference, the Commission indicates that it is not proposing to alter the timing requirement but would permit a pool/RIC to satisfy its reporting obligation by making the monthly statements available on its website.

NFA recognizes that our April 2011 comment letter offered two alternatives to resolve this timing issue—permit RIC's to deliver an account statement on a quarterly basis (which is currently the requirement for CPOs that meet the requirements under Commission Regulation 4.12(b)) or make the monthly statement available on the RIC's website. Upon further consideration of this issue, NFA recommends that the Commission reconsider its decision not to grant relief from this timing issue. NFA suggests that since these pool/RICs post daily net asset values on their websites and provide for daily liquidity, the Commission should consider permitting these funds to prepare quarterly account statements, which is consistent with FINRA timing requirements, and post those statements to their website under the conditions outlined in proposed Regulation 4.12(c)(2)(ii).

Disclosure Document Filing Requirements

NFA's April 2011 comment letter raised an important issue with regard to Regulation 4.21's requirement that a CPO obtain a written acknowledgement of receiving the disclosure document from a prospective participant prior to accepting any funds. The SEC has no comparable requirement.

Specifically, NFA questioned whether this requirement continues to provide a meaningful customer protection benefit and requested that the Commission consider eliminating it altogether for CPOs for any type of pool investment, including RICs and pools registered under the Securities Act of 1933. NFA again recommends that the Commission eliminate Regulation 4.21's signed acknowledgment requirement regarding receipt of the disclosure document for all pools and not just those that are sold pursuant to an effective registration statement under the Securities Act of 1933 or registered under the '40 Act. It is NFA's understanding that the recently enacted

Jumpstart Our Business Startups (JOBS) Act will lead to the removal of many of the advertising restrictions imposed on private offerings under Regulation D, Rule 506 of the Securities Act of 1933 and CPOs may now be able to place their disclosure documents on a website to advertise their pool offerings—in compliance with the relief in Regulation 4.12(c). CPOs should be permitted to accept pool participants on this basis rather than having to obtain a signed acknowledgment regarding receipt of the disclosure document prior to accepting funds.

Additional Issue

Lastly, NFA requests that the Commission provide clarity with respect to one additional issue. Given the SEC's recent requirement that hedge fund advisers become registered, NFA expects that many more firms will be registered with both the SEC and CFTC. Therefore, a minor issue exists with respect to the timing of the distribution of SEC financial statements and CPO annual reports. Specifically, an IA with "custody" of a fund's assets generally complies with the SEC's IA custody rule—Rule 206(4)-2—by distributing to fund investors audited financial statements prepared in accordance with generally accepted accounting principles within 120 days of the fund's fiscal year end (180 days for a fund-of-funds). CFTC Regulation 4.22 requires a CPO of a 4.7 exempt pool to file an annual report with NFA and distribute it to fund investors within 90 days of the fund's fiscal year end.

Under Rule 4.22(f)(2), a CPO that operates a Rule 4.7 exempt pool that is a fund-of-funds may claim a 90-day automatic extension for filing and distributing the pool's annual report, and once this extension is claimed there is no need to re-file for the extension on an annual basis. Therefore, the time period required by the CFTC is consistent with that required by the SEC for funds-of-funds. This, however, is not the case for non-fund-of-funds pools because there is no similar automatic extension for them and only a mechanism for claiming a hardship extension from the NFA under Rule 4.22(f)(1). Therefore, NFA suggests that the CFTC amend Regulation 4.22 so that an IA registered with the SEC operating a Rule 4.7 exempt pool may claim an automatic 30-day extension under Rule 4.22(f)(2) if the pool is not a fund-of-funds, and will not be required to re-file for an extension on an annual basis once an extension is claimed.

Conclusion

NFA encourages the Commission to consider the points raised by NFA in this letter, as well as other issues identified by RICs that will be subject to the dual regulatory structure. As NFA has indicated on numerous occasions, our August 2010 Petition for Rulemaking to amend Regulation 4.5 was not intended to eliminate these RIC product offerings, but rather to ensure that these funds were subject to appropriate

regulatory oversight. Therefore, NFA believes it is of paramount importance that the Commission and the SEC resolve those issues that will make it difficult, if not impossible, for pools registered under the Investment Company Act of 1940 to operate under a dual regulatory structure.

If you have any questions concerning this letter, please do not hesitate to contact me at tsexton@nfa.futures.org or 312-781-1413 or Carol Wooding at cwooding@nfa.futures.org or 312-781-1409.

Sincerely,

Thomas W. Sexton, III
Senior Vice President and
General Counsel

(caw: 4.5 Committee_Harmonization Comment Letter 4.24.12)