SUBMITTED ELECTRONICALLY

June 29, 2012

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

Re: CFTC, Notice of Proposed Rulemaking on Aggregation, Position Limits for Futures and Swaps (RIN 3038-AD82)

Dear Mr. Stawick:

This letter is submitted by the Private Equity Growth Capital Council ("***PEGCC***", "***we***" or "***us***", as applicable), in response to the above-referenced Notice of Proposed Rulemaking on Aggregation, Position Limits for Futures and Swaps (the "***Proposing Release***"), and request for comments, issued by the Commodity Futures Trading Commission ("***CFTC***" or "***Commission***"). The PEGCC is an advocacy, communications and research organization established to develop, analyze and distribute information about the private equity and growth capital investment industry and its contributions to the national and global economy.[1]

As described in more detail below, in order to generate returns for their investors, private equity firms make equity investments through multiple fund vehicles ("***PE funds***") in a variety of unrelated commercial enterprises ("***portfolio companies***"). Portfolio companies may utilize proceeds from these investments for, among other things, operating capital and infrastructure development. PE funds thereby function as a

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[1] Established in 2007, and formerly known as the Private Equity Council, the PEGCC is based in Washington, D.C. The PEGCC's members are 36 of the world's leading private equity and growth capital firms united by their commitment to growing and strengthening the businesses in which they invest. The members of the PEGCC are: American Securities; Apax Partners; Apollo Global Management LLC; ArcLight Capital Partners; The Blackstone Group; Brockway Moran & Partners; The Carlyle Group; CCMP Capital Advisors, LLC; Crestview Partners; The Edgewater Funds; Francisco Partners; Genstar Capital; Global Environment Fund; GTCR; Hellman & Friedman LLC; Irving Place Capital; The Jordan Company; Kelso & Company; Kohlberg Kravis Roberts & Co.; KPS Capital Partners; Levine Leichtman Capital Partners; Madison Dearborn Partners; MidOcean Partners; New Mountain Capital; Permira; Providence Equity Partners; The Riverside Company; Silver Lake; Sterling Partners; Sun Capital Partners; TA Associates; Thoma Bravo; TPG Capital (formerly Texas Pacific Group); Vector Capital; Vestar Capital Partners; and Welsh, Carson, Anderson & Stowe.

conduit between, on the one hand, long-term investors such as public and private pension funds and endowments and, on the other hand, portfolio companies, providing an important alternative source of capital to the economy and an alternative asset class for long-term investment. Our members own interests in hundreds of portfolio companies in diverse businesses across multiple time zones.

PE funds, generally, do not become involved in the day-to-day management of their portfolio companies, and in particular, generally do not control day-to-day trading activities of their portfolio companies. As discussed further below, the Proposing Release would nevertheless require PE funds to more fully insert themselves into the substantive day-to-day trading activities of their portfolio companies by, among other things, monitoring and, in some instances, restricting the derivatives activities of their portfolio companies.[2] This letter explains why such undertakings would create conflicts for PE funds as well as their portfolio companies, would be enormously and unnecessarily burdensome, and would ultimately be counterproductive. This letter then proposes two more workable alternatives that would reduce costs for market participants and would allow portfolio companies to conduct appropriate derivatives activities in a manner consistent with the objectives of the Proposing Release.[3]

Our proposal would permit a majority investor that is a "private investment fund"[4] to be exempt from aggregation in one of two cases:[5]

1. The first proposed exemption would permit a private investment fund with a majority investment in an owned entity not to aggregate with that owned entity if the private investment fund (i) satisfies all of the Conditions (as defined below), other than the Condition restricting the investment to no more than 50 percent; (ii) receives, uses and distributes information concerning the trading of the owned entity only to the extent that such information is necessary or appropriate to conduct prudent risk management; (iii) does not share such information with any personnel making trading decisions (including trading personnel of the private

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2 Proposing Release at 31775.

3 The Rules (as defined below) explain that "[t]he fundamental rationale for the aggregation of positions or accounts is the concern that a single trader, through common ownership or control of multiple accounts, may establish positions in excess of the position limits and thereby increase the risk of market manipulation or disruption." Id. at 71652.

4 We define "private investment fund" as any private fund that (1) does not provide investors with redemption rights in the ordinary course, and (2) calculates incentive fees or allocations (carried interest) based primarily on gains realized from sales or other dispositions of portfolio investments.

5 References to a PE fund throughout the text of this letter are intended to apply to both private equity funds and real estate funds, unless the context requires otherwise.

investment fund and trading personnel of any other entity); and (iv) adopts and enforces written policies and procedures to ensure (ii) and (iii).

2. The second proposed exemption would permit a private investment fund with a majority investment in an owned entity not to aggregate with that owned entity if (i) such private investment fund satisfies all of the Conditions, other than the Condition restricting the investment to no more than 50 percent; (ii) such owned entity represents, on an annual basis, to the private investment fund that such owned entity will only enter into transactions that qualify as bona fide hedging transactions under Section 151.4(a) (or 1.3(z), as applicable), without regard to the filing requirement under Section 151.4(c); (iii) such private investment fund provides a copy of the representation received from its owned entity pursuant to (ii) to the CFTC; and (iv) such private investment fund annually reports the legal entity identifier of each entity in which it holds an ownership or equity interest in excess of 50 percent to a swap data repository ("***SDR***").

The remainder of this letter is divided into six Sections. The first Section provides background on the organization and operations of private equity firms and PE funds; the second Section provides background on the proposed conditional exemption from aggregation applicable to non-majority investments and how the aggregation regime could affect private equity firms (including their PE funds and the portfolio companies of their PE funds); the third Section sets forth and addresses the concerns that the Proposing Release raises for limiting the proposed disaggregation provision to non-majority ownership interests; the fourth Section describes our proposals for exempting majority owned investments from aggregation; the fifth Section sets forth the PEGCC's answers to certain of the specific questions raised by the Proposing Release; and the sixth Section addresses proposals in the release unrelated to the Non-Majority Investor Exemption and concludes.

I. Structure and Operations of Private Equity Firms and Funds

To provide context for the discussion below, here we provide a description of the organization and operations of private equity firms and PE funds:

A. Private Equity Firms

Private equity firms sponsor, manage and advise PE funds (as described below). Private equity firms typically own and control their funds' general partners (or, in the case of a fund that has a non-partnership structure, the equivalent controlling entity), which make investment decisions for the funds ("***GPs***"). Private equity firms most frequently are privately owned and controlled by their senior investment professionals. Subject to limited exceptions (for non-U.S. firms, certain private fund advisers and venture capital firms), investment advisers affiliated with private equity firms are registered as investment advisers under the Investment Advisers Act of 1940.

Advisers to PE funds with at least $150 million in private fund assets under management are also generally required to report on Form PF.

Private equity firms' primary business consists of developing investment strategies for their funds and obtaining outside investment to pursue such strategies. PE funds pursue a variety of investment strategies (*e.g.,* venture capital, growth capital, buyout, real estate, distressed and mezzanine investing) and invest in a broad range of industries and geographies. While an individual PE fund may hold a limited number of investments, and while some private equity firms and/or PE funds have a geographic or industry focus, PE funds in the aggregate are diversified across multiple geographies and industries and thus lack concentrated exposure in any single region or sector.[6]

B. Private Equity Funds: Typical Structure

PE funds are closed-end pooled investment vehicles, most frequently organized as limited partnerships, that invest in portfolio companies. A PE fund typically is controlled by its GP, which makes investment decisions for the fund and is affiliated with the private equity firm that advises the fund. The GP makes a significant capital commitment to the fund, *i.e.*, a contractual agreement to contribute capital from time to time over the term of the fund as and when needed by the fund to make investments and pay expenses.[7] The PE fund also obtains capital commitments, at the beginning of its term, through private placement transactions, from sophisticated third-party investors who agree to become limited partners (or members or shareholders in a non-partnership structure) of the fund ("***LPs***"). The LPs, like the GP, contribute capital to the fund over its term. The LPs are not involved in the management or control of the business of the fund except in very limited circumstances (*e.g.,* to vote on conflicts of interest or to remove the GP). LPs of PE funds include corporate pension plans, public retirement plans, foundations, endowments, sovereign wealth funds, insurance companies and (historically) banks, and to a lesser extent, very high net worth individuals and family offices.

In addition, the GP often designates an affiliated entity to provide investment advice with respect to the PE fund. As noted above, such entity often is registered with the Securities and Exchange Commission under the Investment Advisers

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[6] For example, in 2011, 32 percent of private equity investment in U.S.-based companies occurred in the business products and services sector, 22 percent in the consumer products and services sector, 13 percent in the information and technology sector, 12 percent in the healthcare sector, 9 percent in the financial services sector, 7 percent in the energy sector, and 5 percent in the materials and resources sector. See PitchBook, Annual Private Equity Breakdown 2012, at page 4.

[7] Relative to other investors, however, the GP's economic interest in the portfolio company is usually small and generally does not exceed 10 percent of the company. See n. 12 and n. 15, *infra*.

Act of 1940 and owes fiduciary duties to each of the PE fund entity "clients" with respect to which it provides advisory services.

C. Private Equity Funds: Long-Term Funding, Long-Term Illiquid Investments

As noted above, capital is contributed to a PE fund by its GP and its LPs over the fund's term as and when needed by the fund to make investments and pay its expenses. The term of investments in a PE fund is typically 10 years (subject to extension for up to two or three years if needed by the fund to dispose of any investments then remaining in the portfolio). Most often new investments are made by a fund only during the first three to six years of the fund's term. Whatever the investment strategy or focus of a PE fund, that fund typically invests capital in highly illiquid securities (*i.e.,* securities not tradable on a securities exchange)—common equity and, to a lesser extent, preferred equity or debt securities such as mezzanine debt—of operating businesses. A PE fund typically holds each of its investments for between three and seven years. In each case the fund works to improve the value of the business in which it has invested so that, eventually, that investment may be sold by the fund at a profit based on the value created during the period that the fund owned a stake in that investment.[8]

Regardless of the type of portfolio investment made, the objective of a PE fund is the same: increase the value of the portfolio company during the time that it is owned by the PE fund. PE funds accomplish this by, for example: revitalizing a portfolio company's board of directors; strengthening and adding to (and where necessary replacing members of) the management team; requiring the implementation of management and employee equity stock ownership plans and/or revised performance-based bonus plans; professionalizing financial management of the portfolio company; assisting the company in optimizing its capital structure; providing operational assistance; working with management to develop and implement a new or revised business plan; and/or causing the company, as appropriate, to make capital and R&D expenditures, to cut corporate waste and inefficiencies, to expand into new markets and develop new products, and/or to make strategic acquisitions to create the scale required to compete more effectively and become a market leader.

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[8] Except perhaps for a pledge by a PE fund of the shares of a portfolio company (or a subsidiary of a portfolio company) that it owns as security for that portfolio company's borrowings, the borrowings or other obligations of that portfolio company are not guaranteed by, or secured by pledges of the assets of, the fund or any other portfolio company. Furthermore, to avoid potential piercings of the corporate veil or other legal actions to hold the PE fund or its other portfolio companies liable for the actions of a portfolio company, organizational separations are maintained between PE funds and their portfolio companies as well as between portfolio companies.

D. Private Equity Funds: Strictly Limited Hedging and Trading

As discussed above, the investment strategies of PE funds are mostly long-term "buy and hold" strategies, not trading strategies. Not surprisingly, therefore, PE funds typically are prohibited by the terms of their partnership agreements or other governing documents from trading for speculative purposes (including in commodities or derivatives). PE funds themselves generally use only interest rate and foreign exchange derivatives, and generally do not use derivatives on physical commodities (including any of the commodities underlying the Core Referenced Futures Contracts enumerated in Section 151.2 of the CFTC's Regulations).

II. Aggregation and its Application to Private Equity

A. Background

On October 18, 2011, the CFTC adopted final position limit rules under Part 151 of the CFTC's Regulations (the "***Rules***") for the purpose of preventing "excessive speculation".[9] One of the Rules' components is an aggregation provision that determines which accounts and positions a person must aggregate with its own when applying position limits. In particular, under Section 151.7(b) of the Rules an investor must, subject to certain significant exceptions, aggregate its positions with the positions of any entity in which the investor has a 10 percent or greater ownership or equity interest.[10] This, like other bases for aggregation under Section 151.7 of the Rules, will not only be the standard for aggregation with respect to positions in derivative contracts related to one of the 28 Core Referenced Futures Contracts listed in Section 151.2 of the CFTC's Regulations but also under all position limit and position accountability regimes implemented by designated contract markets and swap execution facilities under Section 151.11(e) of the CFTC's Regulations.[11] The result is that an investor with a 10 percent or greater interest in a company would be attributed a wide variety of derivatives activity engaged in by such company (including, potentially, energy, metal, agricultural, interest rate, currency, and other derivatives activity).

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[9] CFTC, Final and Interim Rules, Position Limits for Futures and Swaps, 76 Fed. Reg. 71626, 71627 (Nov. 18, 2011).

[10] Passive ownership interests of limited partners, shareholders, members of a limited liability company, beneficiaries of a trust and similar types of participations in a commodity pool are not subject to aggregation on account of ownership, except as provided in CFTC Regulation 151.7(c) and 150.4(c), as applicable.

[11] If Section 151.11(e) of CFTC Regulations and other CFTC Regulations will not require exchanges or swap execution facilities to impose position limits or accountability limits on an aggregate basis pursuant to Section 151.7, or if the application of Section 151.7 will be limited so that it does not apply to certain asset classes (e.g., foreign exchange rates or interest rates), we respectfully request that the CFTC confirm this in the release finalizing the Proposing Release.

The Proposing Release would amend Section 151.7(b) to include an additional exemption from aggregation for certain non-majority investments. Specifically, the Proposing Release would add to the CFTC Regulations a new Section 151.7(b)(1) (the "***Non-Majority Investment Exemption***"), which would provide an exemption from aggregation based on ownership where a person holds an interest in an owned entity that is equal to or greater than 10 percent but does not exceed 50 percent, provided that a notice filing is made with the CFTC, and certain conditions designed to protect against coordination of trading activities are met. These conditions require that, on the one hand, the investor and any person with which it is required to aggregate, and on the other hand, the owned entity: (A) do not have knowledge of the trading decisions of the other; (B) trade pursuant to separately developed and independent trading systems; (C) have and enforce written procedures to preclude each from having knowledge of, gaining access to, or receiving data about, trades of the other (including document routing and other procedures or security arrangements, and separation of physical locations, that would maintain the independence of their activities); (D) do not share employees that control the trading decisions of either; and (E) do not have risk management systems that permit the sharing of trades or trading strategy (the restriction that the interest not exceed 50 percent together with conditions (A) through (E), the "***Conditions***").

As described in our comments below, the Non-Majority Investment Exemption represents a necessary, albeit insufficient, modification of the Rules to address the substantial burdens they would otherwise impose on legitimate and long-standing business activity that does not pose the risks that the Rules are intended to address.

B. Aggregation and Private Equity

The Non-Majority Investment Exemption only allows those investors that meet the Conditions to be exempt from aggregation. Because the proposed exemption would be limited to non-majority investments, the exemption would not be available with respect to many investments ordinarily made by PE funds.[12] As a result, the Rules and Proposing Release would create an aggregation regime that would be unworkable for PE funds and would exceed both (i) what is necessary or appropriate to achieve the goals of

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[12] Our concerns with aggregation by virtue of ownership are focused at the PE fund level. In general, the ownership or equity interest of a PE firm sponsor (or its affiliates) in its PE funds will not exceed the 10 percent threshold, and is ordinarily at the one to three percent level. Therefore, the sponsoring GP should not be required to aggregate the positions of a PE fund (or the PE fund's portfolio companies) based on direct or indirect ownership; and furthermore, notwithstanding that the PE firm typically wholly owns the GP, the PE firm should not be required to aggregate with the PE fund on the basis of direct or indirect ownership.

the Rules, and (ii) the CFTC's historical prerequisites to permitting disaggregation.[13] While we acknowledge that aggregation, as a statutory and policy matter, may be appropriate to prevent evasion of position limits through control of trading across entities, and we would support properly crafted aggregation requirements that advance this statutory and policy objective, we respectfully submit that there is little potential for such abuse or concentrations of control in the private equity context and that within this context, narrower and less disruptive means are available to prevent these risks.

The organization and operations of private equity firms neither raise the concerns to which aggregation is addressed[14] nor lend themselves to compliance with the requirements for disaggregation as presently contemplated.[15] PE funds do not typically trade in commodities or derivatives (and, to the extent they do so at all, they engage only in limited interest rate and currency hedging). More importantly, PE funds do not coordinate such trading across their portfolio companies.[16] As discussed above, portfolio companies are generally commercial firms; and, like other commercial firms, portfolio companies typically enter into derivatives to hedge their business operations. Portfolio companies do not obtain each other's positions through the PE fund or any of the PE fund's affiliates. In short, the portfolio companies conduct trading independently of one another, the investing PE fund and the rest of the PE firm. Nevertheless, under the Rules, PE funds together with their independent portfolio companies would become subject to position limits on an aggregate basis.

Because PE funds often take majority positions in their portfolio companies, the Non-Majority Investor Exemption would often be unavailable. This result, we believe, does not further the purpose of the Rules. The structure of private

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[13] The CFTC has permitted disaggregation with respect to passive interests in commodity pools without information barriers or regard to the percentage of the equity in a commodity pool that the investor held. See n. 10.

[14] See n. 3, *supra*.

[15] Unaffiliated investors in PE funds may have equity interests in the fund that exceed the 10 percent threshold. Subject to available exemption, many of these investors (which, as noted, include public and private pension funds and endowments) exceeding the 10 percent threshold would be required to aggregate the positions of portfolio companies in which they are indirectly invested, despite the fact that they have no connection to or involvement in the activities of these companies.

[16] Our proposals incorporate the conditions to the Non-Majority Investment Exemption, which would ensure that trading outside the owned entity is not influenced by any trading information received from the owned entity. Accordingly, to the extent that private equity firms currently receive information regarding trading by their portfolio companies (or any such information is shared with other portfolio companies), disaggregation would be predicated on discontinuing such practices pursuant to information barriers that satisfy the Conditions.

equity firms and the role of PE funds in the management of their portfolio companies justifies permitting PE funds' investments in portfolio companies to be disaggregated. In particular, while PE funds take an active role in the high level governance of their portfolio companies and receive information in connection therewith, they have no involvement in the day-to-day trading operations of portfolio companies.[17] Information that is received by PE fund representatives concerning the trading activities of portfolio companies seldom consists of the type of real-time or intraday position information that could present an opportunity for coordinated trading among the firm and its many portfolio companies, and any individuals receiving portfolio company information with respect to a portfolio company's derivative positions on behalf of a PE fund are generally distinct from those individuals who engage in any trading activity on behalf of the PE fund itself. When a PE fund representative receives information concerning a portfolio company's trading decisions, such individual would not normally share this information with other portfolio companies or otherwise use it to affect any other entity's trading. In other words, information as to activities in derivatives generally flows one way**,** into the PE fund, and is not then used either to trade by the PE fund or to affect the trading of other entities. In these circumstances, aggregation would not be warranted by the purpose of the Rules. Accordingly, we believe that the Non-Majority Investor Exemption should be supplemented with two additional exemptions that would permit disaggregation with respect to majority owned companies subject to the heightened restrictions intended to prevent excessive speculation described in Section IV.

C. Costs of Complying with Aggregation Requirements

Complying with position limits on an aggregated basis would impose substantial burdens on PE funds and their portfolio companies. To comply, PE funds would be forced to determine how the available position limits would be allocated to portfolio companies, which would in turn dictate the level of each portfolio company's derivatives activity based on the activities of other unrelated portfolio companies.[18] As a

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[17] In some circumstances, representatives of PE funds may obtain information related to past or future trading decisions of their portfolio companies, for example, (i) where a representative of a PE fund on a portfolio company's board becomes involved in board level consideration of a transaction involving a significant hedge (such as a loan accompanied by an interest rate swap), (ii) the receipt of periodic (e.g., typically no more frequent than end-of-day) reports of positions for a particular portfolio company within a fund structure for risk management purposes, and (iii) due diligence conducted in the course of acquiring a portfolio company, which involves assessment of the portfolio company's hedging program and other derivatives activities. By integrating the Conditions, our proposals would permit disaggregation only where appropriate information barriers were established, which would limit such activity to the extent it was inconsistent with the Conditions (e.g., where information regarding trading activity of the owned entity was being shared with the PE for purposes other than those consistent with meeting fiduciary or other legal obligations).

[18] If aggregation was required at the PE firm level, the costs of compliance and limitations on portfolio companies' derivatives activity would be further magnified.

result, portfolio companies could be limited in their derivatives activities based on the derivatives activities of other, independent, portfolio companies. These limitations could hamper legitimate hedging and other business activity by the portfolio companies and impose competitive disadvantages on such companies. Resulting restrictions on the derivatives activities of portfolio companies could also reduce liquidity in the market and opportunities for firms to engage in risk management and to observe the development of prices. These costs to investors, commercial firms, and other market participants are considerable, and should not be imposed where more tailored alternatives equally suitable to achieving regulatory goals are available.

In addition, there will be substantial costs in building systems and training personnel to enable compliance on an intraday basis across unrelated portfolio companies. PE funds do not currently have the capacity to monitor portfolio companies' positions on an intraday basis, and developing such capacities would impose substantial burdens on PE funds and their portfolio companies. Ironically, a PE fund could meet these compliance obligations only through obtaining a real-time view of its portfolio companies' positions of the sort that enables coordinated trading. It would be contrary to the purpose of the aggregation regime[19] to require investors that did not otherwise have a real-time view of owned companies' positions to obtain such a view, because it is precisely such information that poses the risks of coordinated trading. This result would be counterproductive from both a regulatory perspective and from the perspective of PE funds (and their investors) that would bear the costs of implementing a compliance regime.

To some extent, the costs of aggregation would be reduced where portfolio companies' derivatives activity qualified as bona fide hedging under CFTC Regulation 151.5(a) (or, with respect to transactions in excluded commodities, 1.3(z)), as such transactions would not need to be taken into account in determining compliance with the position limits.[20] Even where portfolio companies' activities were limited to bona fide

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19 See n. 3, *supra*.

20 The addition of compliance costs with respect to entities that are solely engaged in bona fide hedging is a result of the new notice filing requirements under Part 151. Under Part 150 of the CFTC's Regulations, which has imposed position limits and applicable aggregation requirements that continue to be effective pending imposition of position limit requirements under the Rules, a person was not required to file any forms with the CFTC in order to benefit from the hedging exemption. Rather, the hedging exemption under Part 150 was self-executing and investors in commercial businesses that limited use of derivatives to hedging were not at risk of violating position limits due to the activities of their owned companies. Because the Rules would require owned entities to file for bona fide hedging exemptions under 151.4(c), investors are now exposed to the risk that they will exceed applicable position limits on an aggregate basis notwithstanding that most, if not all, of the positions attributed to them serve hedging purposes and are entered into without any regard to the trading or other activities of the investor or other, commonly owned, entities. This proposed majority exemption described in Section IV of our letter would effectively

hedging transactions, however, compliance costs would still need to be incurred because the PE fund would be compelled to monitor portfolio companies' positions on an intraday basis to ensure that when position limits would otherwise be violated (on an aggregate basis), hedging exemptions were sought. Private equity firms lack the technology and compliance staff resources to implement a program that could perform such monitoring; moreover, the information sharing that would be required to effect such monitoring could conflict with internal policies (including portfolio companies' information barriers) or contractual obligations to which PE funds and/or their portfolio companies are subject.[21] In addition to implementing monitoring, the PE fund would need to have the capacity to compel a portfolio company to file for a hedging exemption; a process for exercising such day-to-day control has not yet been implemented, and in some cases, it may not be possible to compel a portfolio company to file (or timely file) a hedging exemption.[22] Developing and testing of adequate compliance programs would not only be difficult and costly but also time consuming, and could not be completed prior to the expected compliance date under the position limit rules. The administrative burdens of monitoring position limits, and where position limits could be exceeded, prompting portfolio companies to file for hedging exemptions, are significant. We propose an alternative for mitigating such burdens below. Of course, where a portfolio company entered into transactions that did not qualify as bona fide hedging transactions, the PE fund would be required to limit such transactions to the extent that they exceeded applicable limits.

In light of the alternatives presented in this comment letter, which we believe could be adopted without compromising the goals of limiting excessive speculation, we do not believe that the costs of the aggregation provisions in their current form are warranted (which costs include reduced capital availability, narrowed opportunities for long-term investment, restricted derivatives activity by portfolio companies, reduced liquidity in derivatives markets, decreased opportunities for hedging and risk management, as well as the administrative costs of complying with the rules).

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permit an alternative to the notice filing requirements under 151.4(c) to those entities that annually represented that their activities were limited to bona fide hedging transactions.

21 Certain hedging exemptions would require sharing of trading information ahead of the relevant bona fide hedging transaction so as to be able to file a Form 404A. CFTC Regulation 151.10(b)(1) (requiring a filing of Form 404A "at least ten business days in advance of the date that transactions and positions would be established that would exceed a position limit").

22 Additional compliance burdens would be imposed where portfolio companies engaged in transactions that did not qualify as bona fide hedging transactions. Specifically, PE funds would need to develop capacities to restrict their portfolio companies from entering into transactions that would cause the PE fund to violate position limits on an aggregated basis.

D. Confirmation of the Scope of the Conditions

In light of the foregoing, and particularly the limited role of PE funds with respect to the management of portfolio companies, the portfolio companies' use of derivatives and the restrictions imposed by the Conditions, we respectfully request that the Commission clarify and confirm, in the release finalizing the Proposing Release, that the Conditions, with respect to any investment of greater than 10 percent, permit and contemplate the type of high level oversight of owned entities exercised by PE funds, as described above. We believe that the type of role we have outlined is fully consistent with the language, spirit and intent of the Rules and with the Conditions, and reflects only the level of oversight and governance involvement necessary to enable PE funds and their representatives on the boards of directors of portfolio companies to fulfill their obligations under applicable law, including the fiduciary duties of portfolio company board members, the fiduciary duties of PE funds and the fiduciary duties of registered investment advisers. However, given the fact that these issues were not specifically addressed in the proposal, we believe it is necessary and appropriate for the CFTC to provide confirmation on these points and we urge the CFTC to do so.[23]

III. Regulatory Concerns Do Not Mandate Aggregation of Majority Investments

Section 4a(a)(1) of the Commodity Exchange Act applies the position limits established by the CFTC to "the positions held and trading done by any persons directly or indirectly controlled."[24] The language does not mandate aggregation of the positions of separate legal entities based solely on common ownership. While ownership, in some circumstances, may create the potential for control and thus may be a useful proxy for the risk that an entity may control the trading of another, there is no question that the statutory language does not *require* the CFTC to attribute positions held by a

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[23] Limiting the restriction on sharing information to a level that is consistent with the investor's and its agents' fiduciary duties and other legal obligations would be in accordance with the CFTC's existing exemptions from disaggregation. See CFTC Regulation 151.1, 151.7 (permitting an entity disaggregating the positions controlled by an independent account controller to nevertheless maintain "such minimum control as is consistent with its fiduciary responsibilities for managed positions and accounts to fulfill its duty to supervise diligently the trading done on its behalf or as is consistent with such other legal rights or obligations which may be incumbent upon the eligible entity to fulfill."); 151.7(e)(2) (permitting a futures commission merchant (FCM) to disaggregate an account controlled by another trader notwithstanding that the FCM maintains such "minimum control over the trading in such an account as is necessary to fulfill its duty to supervise diligently trading in the account.").

[24] Section 4a(a)(1) also provides for aggregation with respect to "positions held by, and trading done by, two or more persons acting pursuant to an expressed or implied agreement or understanding." This basis for aggregation is not implicated in the circumstances addressed in this letter.

person to any investor in such person.[25] Indeed, the CFTC has recognized that there is no statutory requirement to aggregate on the basis of ownership alone through its adoption of an exemption from aggregation for investments in commodity pools, which exemption does not turn on the percentage interest in the commodity pool owned by the investor.[26] As discussed further herein, the language of Section 4a provides the CFTC with ample authority to exempt a non-controlling investor from aggregation, irrespective of the relative size of its investment. We respectfully request that the CFTC exercise this authority so as to permit disaggregation where an investor's interest exceeds 50 percent as we propose in Section IV.[27]

We also note that the relief recommended herein is fully consistent with exemptions from aggregation previously adopted by the CFTC, even in instances involving trading by a wholly owned, or even the same, legal entity. For example, the exemptions from aggregation with respect to passive investments in commodity pools under CFTC Regulations 150.4(b) and 151.7(b) recognize the utility of pooled investment vehicles and the customary lack of control by investors using such structures. These exemptions permit disaggregation despite majority or even one hundred percent ownership and do not impose any information barrier requirements. Similarly, exemptions from aggregation created in circumstances involving futures commission merchants and independent account controllers ("***IACs***") under CFTC Regulations 151.7(e) and 151.7(f), respectively, permit disaggregation of accounts controlled by the *same* legal entity provided adequate separations have been implemented between the traders managing such accounts. There is no basis for the imposition of more stringent

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[25] The Proposing Release explains that the legislative history of Section 4a of the CEA "indicates that Congress added . . . language to expressly incorporate prior administrative determinations of . . . [the] predecessor to the Commission" and goes on to state that such administrative determinations and regulations of the predecessor announced standards that included control of trading and the ownership of positions. Id. at 31772. The cited legislative history, administrative determination and rules, however, concern aggregation between positions owned by the same person in accounts held at different entities (*e.g.*, distinct clearing brokers), rather than aggregation of accounts that belong to another entity based on an ownership interest in such other entity. See id. at n. 60, 61. The statute does call for aggregation of an entity's trading accounts notwithstanding that they are, *e.g.*, held at different futures commission merchants. The Non-Majority Investment Exemption, however, does not address the question as to whether positions of the *same entity* held at different entities should be aggregated; rather the Non-Majority Investment Exemption (like this letter) addresses the question of whether the positions of *another entity* should be aggregated with the positions of an investor in that other entity. The limited legislative history the Proposing Release draws on for its reading of Section 4a as requiring aggregation on account of either ownership or control does not address this latter question.

[26] See CFTC Regulations 150.4(b) and 151.7(b).

[27] Again, we recognize that in some industries, majority ownership will be accompanied with control of trading activities. However, as discussed above, this is not typically the case with private equity firms.

limitations on PE funds investing in operating commercial entities that use derivatives for hedging, risk management or other commercial purposes.

The Proposing Release identifies three bases for the 50 percent threshold: (i) the administrative costs for the CFTC[28] and market participants in the absence of a bright line threshold, (ii) concerns that an ownership interest exceeding 50 percent "presents heightened concerns for coordinated trading or direct or indirect influence over an account or position", and (iii) that "permitting disaggregation at [a level of ownership in excess of 50 percent] would be inconsistent with the statutory requirement to aggregate on the basis of ownership." We address these three justifications in turn.

The first justification for setting a maximum threshold of 50 percent offered by the Proposing Release is that it eases administrative concerns for both the market participants and the CFTC.[29] Permitting investors to avail themselves of an elective exemption from aggregation does not increase administrative burdens for market participants as they retain the choice of not filing for the exemption. Accordingly the expansion of disaggregation proposed in our letter would not increase administrative burdens for market participants, as it provides them with the choice to forego qualifying for the exemption (and thus remaining in the same position as they would be in if the exemption was unavailable).

To the extent that the expansion of disaggregation for majority investments proposed in Section IV of our letter results in additional burdens on the CFTC, we believe those burdens are relatively minimal in comparison with the accompanying (i) reductions of compliance costs to market participants, and (ii) increases in benefits to commodity markets in terms of improved price discovery through additional liquidity and opportunities to engage in risk management activities. Like the Non-Majority Investor Exemption, the proposals in this letter would effectively establish a "rebuttable presumption that persons with an ownership or equity interest" exceeding a threshold must aggregate their positions, but permit such persons to rebut this presumption by demonstrating independence. The burden of making this showing to the CFTC's satisfaction would rest on the investor and its owned entities, which could limit the administrative burdens imposed on the CFTC to those of reviewing the submitted filings. As discussed below, additional reporting requirements could be imposed on PE funds that would actually reduce the administrative costs to the CFTC by providing information on the relationships between investors and their owned entities. This information would supplement information already available to the CFTC and would

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28 The Proposing Release explains that "[a]bsent aggregation on the basis of ownership, the [CFTC] would have to apply a control test in all cases, which poses significant administrative challenges to individually assess control across all market participants." Id. at 31773.

29 Id. at 31773.

enhance the CFTC's ability to detect instances of potential attempts to manipulate markets or other coordinated trading and other improper activities resulting from relationships between PE funds and their portfolio companies. The CFTC would also likely save administrative costs in the reduced number of hedging exemptions that portfolio companies would otherwise file. In exchange for some limited increased administrative costs that the proposed exemptions may impose on the CFTC, market participants would be able to continue established business practices of entering into derivatives that do not implicate concerns of excessive speculation through coordination of positions. Continuation of these established business practices would serve to increase liquidity, promoting both price discovery and the availability of open interest to meet risk management needs.

The second justification for setting a maximum threshold of 50 percent offered by the Proposing Release is that it addresses the heightened concerns that a majority investor will be able to influence, or coordinate with, the trading activities of the owned entity. We acknowledge that, in some circumstances, an investor with a majority interest in an owned entity could use such interest to obtain information and coordinate trading with such owned entity. There are also circumstances, however, where investors with majority interests are minimally involved with the day-to-day management of their portfolio companies and even purposefully create separations between themselves and the companies in which they have investments, as well as separation among such companies. This is traditionally the case with PE funds. Inversely, instances of control through ownership may exist where the investor's interest is below 50 percent, and yet the CFTC has permitted relying on information barriers to control the flow of trading information in such instances (including in the Proposing Release), and even in cases of greater than 50 percent with respect to other types of entities.[30] We submit that the circumstances involving a greater than 50 percent interest can be addressed in a similar fashion. While PE funds may obtain information concerning the operation of their portfolio companies, they do so in an investor capacity pursuant to their rights and interests as equity holders rather than to coordinate their own operations with those of their investments.[31] Because the expansion of disaggregation with respect to certain majority investors proposed in this letter would be conditioned on complying with strict information barrier requirements, the exemptions would not compromise the regulatory concerns underlying the Rules[32] and would be consistent with exemptions from aggregation previously adopted by the CFTC.

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30 See n. 10 (discussing disaggregation of passive investments in commodity pools), *supra*; n. 42 (discussing aggregation of positions held by the same entity), *infra*.

31 See discussion in Section I and Section II.2.

32 See n. 3, *supra*.

The third justification for setting a maximum threshold of 50 percent offered by the Proposing Release is that disaggregation above this threshold would be "inconsistent with the statutory requirement to aggregate on the basis of ownership." We respectfully submit that this third justification is based on an inaccurate reading of the statute, which is furthermore directly inconsistent with CFTC precedent and practice.[33] Section 4a(a)(1) does not specify any degree of ownership beyond which aggregation is automatically required, without some finding of actual control.[34] This is textually evident on the face of the statute. Furthermore, a contrary view is inconsistent with the CFTC's Regulations under Parts 150 and 151, which permit disaggregation with respect to investments in commodity pools, irrespective of the proportion of ownership or equity interest held in such a pool.[35] Contrary to the Proposing Release, there is nothing in the statutory language of Section 4a(a)(1) or legislative history that restricts the CFTC from providing an exemption from aggregation if an ownership or equity interest exceeds 50 percent.[36]

IV. Proposal for Exempting Majority Investments from Aggregation

This section provides two separate and independent proposals, each of which we believe would address the purpose of the aggregation requirements without disrupting necessary and customary investment activities. We respectfully request that both exemptions be incorporated as part of the final rule. These proposals are intended to be independent and severable, and we respectfully request that, if the CFTC chooses not to adopt one approach, that it nevertheless consider adopting the other.

Each of the proposed exemptions would be available only to "private investment funds", a defined term that is intended to be limited to the type of vehicles for making long term investments that are described in this letter. The proposed definition of "private investment fund" is included in Appendix A hereto.

The first proposed exemption would permit a private investment fund with a majority investment in an owned entity not to aggregate with that owned entity if the private investment fund (i) satisfies all Conditions, other than the Condition restricting

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[33] See n. 25, *supra*, explaining why the legislative history cited by the Proposing Release for the proposition that Section 4a requires aggregation of positions owned by another entity is inapposite.

[34] Furthermore, while Section 4a(a)(1) requires aggregation of "positions held, and trading done by any persons directly or indirectly controlled by [a] person", it does not anywhere refer to aggregation of positions held by another person that is not controlled. Id.

[35] CFTC Regulations 150.4(b) and 151.7(b).

[36] See n. 25, *supra*.

the investment to no more than 50 percent; (ii) receives, uses and distributes information concerning the trading of the owned entity only to the extent that such information is necessary or appropriate to conduct prudent risk management; (iii) does not share such information with any personnel making trading decisions (including trading personnel of the private investment fund and trading personnel of any other entity); and (iv) adopts and enforces written policies and procedures to ensure (ii) and (iii).[37]

The second proposed exemption would permit a private investment fund with a majority investment in an owned entity not to aggregate with that owned entity if (i) such private investment fund satisfies all Conditions, other than the Condition restricting the investment to no more than 50 percent; (ii) such owned entity represents, on an annual basis, to the private investment fund that such owned entity will only enter into transactions that qualify as bona fide hedging transactions under Section 151.4(a) (or 1.3(z), as applicable), without regard to the filing requirement under Section 151.4(c); (iii) such private investment fund provides a copy of the representation received from its owned entity pursuant to (ii) to the CFTC; and (iv) such private investment fund annually reports the legal entity identifier of each entity in which it holds an ownership or equity interest in excess of 50 percent to an SDR.[38] Because the portfolio company's activities would be restricted to bona fide hedging, permitting an exemption in these circumstances would not implicate the concerns of "excessive speculation."[39] Furthermore, the data regarding entities in which a private investment fund has a majority interest could be used by the CFTC to monitor the positions of firms that have majority investments in one or more other companies together with the positions of such other companies for any

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[37] Adopting the proposed relief would be consistent with established practice of permitting disaggregation on the basis of similar information barriers. Under the independent account controller exemption, the CFTC has permitted disaggregation of positions controlled by distinct IACs notwithstanding information sharing for risk management, investor protection and other compliance purposes, provided that IACs "ha[ve] no knowledge of [each others'] trading decisions." See CFTC Regulation 151.1 ("Independent Account Controller means a person . . . over whose trading the eligible entity maintains only such minimum control as is consistent with its fiduciary responsibilities for managed positions and accounts to fulfill its duty to supervise diligently the trading done on its behalf or as is consistent with such other legal rights or obligations which may be incumbent upon the eligible entity to fulfill.") The IAC exemption has been accepted in CFTC practice for over two decades. See CFTC, Exemption from Speculative Position Limits for Positions Which Have a Common Owner, but Which are Independently Controlled, 55 Fed. Reg. 30926 (July 30, 1990).

[38] Such legal entity identifier information would be provided as level two non-public data, in addition to any level two data required to be included with transactional reports. See CFTC Regulation 45.6. Please note that finalized reporting rules would only identify the ultimate parent, and not intermediate parents, in the level two data. Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2136, 2164 (Jan. 13, 2012).

[39] See n. 20.

activity consistent with excessive speculation.[40] Since PE funds generally do not trade derivatives and do not trade in size themselves, they often are not identified to the CFTC by the filing of a Form 40 or otherwise. This proposal would make PE funds known to the CFTC and would identify those portfolio companies that trade derivatives and in which a PE fund has a majority interest.[41]

Each of these proposed exemptions would be elective, meaning that an investor with a majority interest that was otherwise subject to aggregation with an owned entity would not be required to satisfy the conditions for the exemption; rather, the investor could choose to aggregate the positions of such owned entity with the investor's other positions (including those attributed to the investor as a result of aggregation with other entities). In other words, a PE fund could choose to seek the proposed exemptions with respect to some portfolio companies but not others. Accordingly, these proposals would not increase administrative burdens on market participants. Revisions to Part 151 that would implement both proposals are included in Appendix A as proposed Sections 151.7(b)(2) and (b)(3).

V. Responses to the Proposing Release's Specific Requests for Comment

The Proposing Release includes a number of requests for comments relating to the Non-Majority Investor Exemption, which are copied below. Many of these requests have been addressed in the above discussion, which further supports the expansion of relief for majority investments proposed herein. To the extent that the PEGCC has additional comments on any of the specific requests for comment included in the Proposing Release, such comments are noted following the relevant request below.

- *The Proposing Release "requests comments as to the appropriateness of the [Non-Majority Investment Exemption] as well as the conditions applicable to the exemption. Should the Commission add additional criteria? If so, what criteria and why?"*

Our views on the Non-Majority Investment Exemption are discussed in Sections II and III. As explained in those Sections, we believe that the proposed exemption is appropriate in concept but insufficient to address concerns that aggregation would be overbroad relative to the regulatory goals motivating the Rules, disruptive to

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[40] For purposes of ensuring compliance with position limits a designated contract market (DCM) or swap execution facility (SEF) establishes under CFTC Regulation 151.11, such DCM or SEF, as applicable, could require similar reporting with respect to investors in entities trading derivatives based on contracts such SEF\DCM lists and commodities underlying such contracts.

[41] To be clear, these reporting obligations would be in addition to any other applicable reporting obligations under the Commodity Exchange Act and CFTC Regulations thereunder, including the reporting obligations under Parts 43 and 45 of CFTC Regulations.

legitimate business practices, and harmful to the liquidity of derivatives markets in a manner that would interfere with price discovery and risk mitigation. We also seek confirmation that the Conditions permit, on the one hand, the investor and any person with which it is required to aggregate, and on the other hand, the owned entity, to share such information as is consistent with satisfying their fiduciary and other legal obligations.

- *The Proposing Release asks if "the Commission [should] require market participants to submit additional information to claim the exemption? If so, what information and why?"*

We do not believe that additional information should be required to be submitted with the notice filing made to obtain the Non-Majority Investor Exemption. In circumstances where additional information would be appropriate to verify that the filer is qualified for the exemption, the CFTC could request such additional information under CFTC Regulation 151.7(h)(2). However, as explained above, with respect to majority investments, we believe that it may be appropriate to require information concerning corporate ownership with the notice filing for disaggregation under the second of our proposals that would permit disaggregation for PE funds holding a majority interest.

- *The Proposing Release seeks comment as to whether "interests [meeting the conditions of the Non-Majority Investment Exemption] present a significantly reduced risk of coordinated trading compared to owned entities that fail the criteria for the proposed exemption. In addition, the Commission specifically requests comment as to whether the proposed relief should be limited to ownership interests in nonfinancial entities."*

We believe that robust information barriers may be used to ensure and demonstrate independence of trading even within entities, as has been recognized by CFTC regulations in a number of contexts for over two decades.[42] If such practices have been accepted as the means to ensure and demonstrate independence of trading decisions carried out by the same entity, similar practices should be recognized as sufficient to ensure independence of trading decisions carried out by different entities. Accordingly, the CFTC is urged to recognize that where appropriate procedures are adopted and enforced to ensure that an investor does not take an active role in trading, aggregation would not be appropriate.

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[42] See CFTC Regulation 151.7(c)(1) (permitting disaggregation notwithstanding that a passive investor is a principal or affiliate of a commodity pool's operator provided, inter alia, certain procedures to ensure independence of trading are maintained); CFTC Regulation 151.7(e) (permitting disaggregation of a futures commission merchant's accounts provided, inter alia, certain procedures to ensure independence of trading are maintained); CFTC Regulation 151.7(f) (permitting disaggregation of an eligible entity's positions controlled by IACs, provided, inter alia, certain procedures to ensure independence of trading are maintained).

- *"With regard to the owned entity exemption, should the Commission alter the scope of the exemption? If so, how should it be altered and why?"*

The PEGCC explains why the proposed exemption should be broadened to permit disaggregation with respect to majority investments in Sections III and IV of this Letter. Our specific proposals for revising the proposed exemption are outlined in Section IV.

- *"[A]t what percent of ownership interest should a market participant no longer be able to claim the exemption proposed in regulation 151.7(b)(1), if any?*

  Please see the discussion in Section IV.

- *Are there specific circumstances in which a higher percentage of ownership than 50 percent would be appropriate to claim the exemption in regulation 151.7(b)(1) notwithstanding the concerns described above regarding coordinated trading, direct or indirect influence, and significantly large and potentially unduly large overall positions in a particular commodity?"*

  Please see the discussion in Section IV.

- *The Proposing Release also notes that the "Commission welcomes comment on the owned non-financial entity exemption set forth in appendix A of the aggregation petition as an alternative to the owned entity exemption proposed herein."*

The PEGCC supports the owned non-financial entity exemption set forth in Appendix A to the referenced petition submitted by the Working Group for Commercial Energy Firms as an alternative to the proposal in this letter.

VI. Other Elements of the Proposing Release

The Proposing Release would revise aggregation under the Rules in a number of respects that are not addressed in this letter. We generally do not have opinions on these other proposals; however, we do believe that the requirement of obtaining a letter from counsel in support of a filing for disaggregation under CFTC Regulation 151.7(i), *i.e.*, where information sharing would violate law, would be unduly burdensome and should be excised. Law firms will be unwilling to take a position that certain conduct could violate law, as such positions will likely be inconsistent with arguments they are making, or may in the future make, in the course of administrative, judicial or other legal actions on behalf of clients accused of violating relevant provisions of law.

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In sum, the PEGCC supports the expansion of bases for disaggregation pursuant to the Proposing Release. The PEGCC believes, however, that the release does not go far enough in recognizing the costs aggregation will impose and alternatives available. In particular, the PEGCC respectfully urges the CFTC to recognize that disaggregation is entirely appropriate (including with respect to majority investments) if a PE fund qualifies for either of our two proposed exemptions.

If relief for PE funds is not provided, the costs would be enormous and affect not only private equity firms but also current and potential portfolio investments, as well as derivatives markets generally.

The PEGCC appreciates the CFTC's consideration of this letter and is available to discuss any questions that the CFTC may have.

Respectfully submitted,

Steve Judge
President and CEO
Private Equity Growth Capital Council

Appendix A

Proposed Revisions to CFTC Regulations

Proposed revisions to § 151.1

Private Investment Fund means any private fund that (1) does not provide investors with redemption rights in the ordinary course, and (2) calculates incentive fees or allocations (carried interest) based primarily on gains realized from sales or other dispositions of portfolio investments;

Proposed addition of § 151.7(b)(2)

(2) Any Private Investment Fund with a 50 percent or greater ownership or equity interest in an owned entity, need not aggregate the accounts or positions of the owned entity with any other accounts or positions such Private Investment Fund is required to aggregate, provided that:

(i) such Private Investment Fund, including any entity with which such Private Investment Fund would otherwise be required to aggregate, and the owned entity meets the conditions of Subsection 151.7(b)(1) other than Subsection 151.7(b)(1)(ii);

(ii) such Private Investment Fund receives, uses and distributes information concerning the trading of the owned entity only to the extent that such information is necessary or appropriate to conduct prudent risk management;

(iii) such Private Investment Fund does not share such information with any personnel making trading decisions (including trading personnel of the Private Investment Fund and trading personnel of any other entity); and

(iv) such Private Investment Fund adopts and enforces written policies and procedures to ensure (ii) and (iii).

Proposed addition of § 151.7(b)(3)

(3) Any Private Investment Fund with a 50 percent or greater ownership or equity interest in an owned entity, need not aggregate the accounts or positions of the owned entity with any other accounts or positions such Private Investment Fund is required to aggregate, provided that:

(i) such Private Investment Fund, including any entity with which such Private Investment Fund would otherwise be required to aggregate, and the owned entity meets the conditions of Subsection 151.7(b)(1) other than Subsection 151.7(b)(1)(ii);

(ii) such owned entity represents, on an annual basis, to the Private Investment Fund that such owned entity will only enter into transactions that qualify as bona fide hedging transactions under Section 151.4(a) (or 1.3(z), as applicable), without regard to the filing requirement under Section 151.4(c);

(iii) such Private Investment Fund provides a copy of the representation received from its owned entity pursuant to (ii) to the CFTC; and

(iv) such Private Investment Fund reports annually to a registered swap data repository, as defined in Section 49.2(a)(11) of this Chapter, the legal entity identifier, established pursuant to Section 45.6, of any person in which it has a greater than a 50 percent ownership or equity interest.