

MEMO# 24600

October 8, 2010

Draft Letter on NFA Petition to Narrow CFTC Rule 4.5 Exclusion For Investment Companies; Comments Due To ICI By October 14

[24600]

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TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 20-10
ETF ADVISORY COMMITTEE No. 43-10
SEC RULES COMMITTEE No. 40-10 RE: DRAFT LETTER ON NFA PETITION TO NARROW CFTC
RULE 4.5 EXCLUSION FOR INVESTMENT COMPANIES; COMMENTS DUE TO ICI BY OCTOBER
14

The Commodity Futures Trading Commission ("CFTC") has published for comment a petition for rulemaking from the National Futures Association ("NFA") to amend CFTC Rule 4.5, which excludes registered investment companies ("funds") and certain "otherwise regulated persons" from regulation as commodity pool operators. [\[1\]](#) The petition asks that the scope of the Rule 4.5 exclusion be narrowed significantly, but only as applied to funds. ICI has prepared a draft comment letter, which is attached and briefly summarized below.

We will hold a conference call to discuss ICI's draft letter on Wednesday, October 13 at 2:00 pm ET. If you plan to participate, please RSVP to Gwen Kelly by phone (202/326-5818) or email (gwen.kelly@ici.org) by noon on October 13. If you cannot participate, please provide any comments to Rachel Graham by phone (202/326-5819) or email (rgraham@ici.org), preferably before the conference call. The comment letter must be filed with the CFTC no later than Monday, October 18.

By way of background, prior to August 2003, Rule 4.5 required funds and other qualifying entities to comply with restrictions regarding positions in commodity futures or commodity option contracts held for non-bona fide hedging purposes and the marketing of shares/interests to the public ("Pre-2003 Restrictions"). The NFA describes its proposed amendments to Rule 4.5 as an effort to "restore operating restrictions on registered

investment companies that are substantially similar to those in effect prior to 2003.”

The draft letter asserts that the CFTC’s amendments to Rule 4.5 in 2003—which eliminated the Pre-2003 Restrictions—rightly acknowledged that funds do not need to be subject to the full weight of CFTC and NFA regulation and oversight. It states that the NFA has failed to present a compelling case that a different conclusion is now warranted. The draft letter further explains that the NFA is not simply seeking a return to the Pre-2003 Restrictions, but hopes to broaden them by: (1) expanding the 2003 non-hedging restriction such that any positions in commodity futures or commodity option contracts for non-hedging purposes would need to be held “by a qualifying entity only” (thus effectively precluding a fund from using a wholly-owned subsidiary to engage in a limited amount of futures trading); and (2) expanding the 2003 marketing restriction such that Rule 4.5 would be unavailable to any registered investment company that markets its shares as participations in a vehicle otherwise seeking investment exposure to the commodity futures or commodity options markets. The draft letter asserts that the NFA has failed to demonstrate why such requirements would be appropriate.

The draft letter further observes that, in light of the Dodd-Frank Act and related regulatory changes, it is unclear to what extent swaps might be covered by Rule 4.5. Many registered investment companies, including fixed-income funds, use interest rate and total return swaps as part of their principal investment strategies. The letter states that adopting the restrictions advocated by the NFA, and then applying those restrictions to swaps, could have severe negative consequences for a broad range of registered investment companies.

As the draft letter points out, the NFA asks that the full range of CFTC and NFA rules and oversight be imposed on any fund offered to retail investors that engages in “more than a de minimis amount of futures trading,” yet does not seek to impose this additional layer of regulation on other qualifying entities that, like funds, are subject to an alternate regulatory scheme and offered to retail investors. The letter asserts that the NFA petition provides no justification in support of the disparate regulatory treatment that it proposes.

Rachel H. Graham
Senior Associate Counsel

[Attachment](#)

endnotes

[\[1\]](#) Petition of the National Futures Association, Pursuant to Rule 13.2, to the U.S. Commodity Futures Trading Commission to Amend Rule 4.5, 75 Fed. Reg. 56997 (Sept. 17, 2010).