MEMO# 24422

July 15, 2010

NFA Petitions CFTC To Restrict Investment Company Exclusion From Rules Governing Commodity Pool Operators; July 21 Call

[24422]

July 15, 2010

TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 12-10
ETF ADVISORY COMMITTEE No. 28-10
SEC RULES COMMITTEE No. 28-10 RE: NFA PETITIONS CFTC TO RESTRICT INVESTMENT COMPANY EXCLUSION FROM RULES GOVERNING COMMODITY POOL OPERATORS; JULY 21 CALL

The National Futures Association (NFA) has filed a petition for rulemaking with the Commodity Futures Trading Commission (CFTC) to amend CFTC Rule 4.5, which provides a conditional exclusion from the definition of "commodity pool operator" to the operators of certain regulated entities, including investment advisers to registered investment companies. [1]

> We will hold a conference call to discuss to discuss the NFA petition and its possible implications for registered investment companies on Wednesday, July 21 at 2:00 pm ET. The dial-in number for the call is (800) 369-1866 and the passcode is 54003. If you plan to participate, please RSVP to Gwen Kelly via email (gwen.kelly@ici.org) on or before 11 am ET on July 21. If you cannot participate, please provide any feedback on the NFA petition to Rachel Graham by phone (202/326-5819) or email (rgraham@ici.org) before the call if possible.

Prior to 2003, investment advisers seeking to rely on the exclusion in Rule 4.5 were required to file a notice of eligibility with the CFTC representing that, among other things: (1) the commodity futures or option contracts entered into by the registered investment company were for bona fide hedging purposes and the aggregate initial margin and/or premiums for any positions not meeting this standard would not exceed 5% of the liquidating value of the investment company's portfolio; and

(2) shares in the investment company would not be marketed as participations in a commodity pool or a vehicle for trading commodity futures or options. In August 2003, the CFTC eliminated these two conditions as part of a broader rulemaking intended to "encourage and facilitate participation in the commodity interest markets by additional collective investment vehicles and their advisers, with the added benefit to all market participants of increased liquidity." [2]

In its petition, the NFA asks the CFTC to reinstate the conditions on bona fide hedging and marketing outlined above, and to broaden the marketing condition to preclude the marketing of shares in the investment company (or other qualifying entity) as participations in a vehicle otherwise seeking investment exposure to the commodity futures or commodity options markets (emphasis added). The petition states that NFA has become aware of at least three entities filing for exclusion under Rule 4.5 that operate mutual funds that are marketed as commodity futures investments and are indirectly invested substantially in derivatives and futures products. The NFA expresses concern with these mutual fund structures "and the lack of adequate retail customer protections comparable to those afforded prospective investors in a public commodity pool" subject to CFTC regulation.

Rachel H. Graham
Senior Associate Counsel

endnotes

[1] The NFA petition is available at http://www.nfa.futures.org/NFA-regulation/regulationPetition.asp?ArticleID=2491.

[2] See Additional Registration and Other Regulatory Relief for Commodity Pool Operators and Commodity Trading Advisors, 68 Fed. Reg. 12622, 12625 (March 17, 2003) (proposing release).
