The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 26301

July 16, 2012

ICI Draft Comment Letter on CFTC's Proposed Rules Prohibiting Aggregation of Orders to Satisfy Minimum Block Sizes or Cap Size Requirements - Comments Requested by July 23

[26301]

July 16, 2012

TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 32-12
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 22-12
SEC RULES COMMITTEE No. 44-12 RE: ICI DRAFT COMMENT LETTER ON CFTC'S PROPOSED RULES PROHIBITING AGGREGATION OF ORDERS TO SATISFY MINIMUM BLOCK SIZES OR CAP SIZE REQUIREMENTS - COMMENTS REQUESTED BY JULY 23

The Commodity Futures Trading Commission ("CFTC") recently proposed provisions related to block trades in swaps. [1] The Proposal would prohibit the aggregation of orders for different trading accounts to satisfy the minimum block size or cap size requirements except for orders aggregated by certain persons and would specify the eligible parties to a block trade. [2]

Comments on the Proposal are due to the CFTC no later than July 27, 2012. The Institute has prepared a draft comment letter, which is attached and briefly summarized below. If you have comments on the draft letter, please provide them to Jennifer Choi at jennifer.choi@ici.org by Monday, July 23.

The draft letter generally supports the CFTC's proposed exceptions from the prohibition from aggregation but seeks several modifications to the conditions for the exceptions and a technical clarification regarding the provision on eligible block trade parties. The draft letter strongly supports the CFTC's determination that certain persons, including investment advisers, have legitimate reasons for aggregating orders and should be permitted to treat such orders placed as a block trade if the trade satisfies the minimum block size. The letter, however, expresses concern with the exceptions as currently proposed in two areas – one with the general criteria that the persons eligible for the exceptions have at least $25 million in total assets under management and a second concern specific to the exception for investment advisers.

First, although advisers to registered funds typically would have more than $25 million in total assets under management, even advisers with less than the proposed assets have a valid need to engage in block trades on behalf of their funds. The draft letter argues that the exception should not be limited to advisers that manage a certain level of assets because there is no relationship between the amount of assets managed and the legitimacy of aggregating client orders. For these reasons, the draft letter recommends that the assets under management criterion also should not be linked to swap assets, be required per asset class, or be different for the five different asset classes of swaps.

Second, the Proposal would except an investment adviser who has discretionary trading authority or directs client accounts if the adviser satisfies the criteria of Rule 4.7(a)(2)(v) under the Commodity Exchange Act. Under this rule, an investment adviser must be registered pursuant to section 203 of the Investment Advisers Act of 1940 ("Advisers Act") or pursuant to the laws of any state, or a principal thereof, and (1) has been registered and active as such for two years or (2) provides securities investment advice to securities accounts which, in the aggregate, have total assets in excess of $5 million deposited at one or more registered securities brokers. The draft letter expresses concern about the requirement that newly registered investment advisers provide advice to accounts deposited at one or more registered securities brokers. Registered investment advisers may not be able to satisfy the requirement that the assets be deposited at a securities broker because fund assets are generally held in the custody of a bank. The letter requests that the CFTC not reference Rule 4.7 but instead require that the adviser be registered under section 203 of the Advisers Act or pursuant to any state or a principal thereof without specifying a minimum number of years registered or where the client assets are deposited.

Finally, the draft letter requests a technical amendment to clarify that only a person transacting a block trade on behalf of a customer who is not an eligible contract participant ("ECP") must receive prior written instruction or consent from the customer.

Jennifer S. Choi
Senior Associate Counsel – Securities Regulation

Attachment

endnotes

[1] Rules Prohibiting the Aggregation of Orders to Satisfy Minimum Block Sizes or Cap Size Requirements, and Establishing Eligibility Requirements for Parties to Block Trades, RIN 3038-AD84, 77 FR 38229 (June 27, 2012), available at http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-15481a.pdf ("Proposal"). For a summary of the Proposal, see ICI Memorandum No. 26269 (June 27, 2012), available at http://www.ici.org/my_ici/memorandum/memo26269.

[2] A block trade has a notional or principal amount at or above the appropriate minimum block size and is reported publicly subject to time delay requirements. A cap size is the maximum notional or principal amount of a publicly reportable swap transaction that is publicly disseminated. A transaction that meets the cap size requirement would be eligible to mask the total size of the transaction if it equals or exceeds the applicable cap size.