The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 26733

November 30, 2012

CFTC Staff Issues Fund of Funds Extension; Rule 4.5 Letters to CFTC on (1) Temporary Extension Relating to Investments in Securitization Vehicles and (2) Application of the CFTC's Disclosure Rules to Funds Within Series Companies

[26733]

November 30, 2012

TO: SEC RULES MEMBERS No. 108-12
COMPLIANCE MEMBERS No. 27-12
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 68-12
CLOSED-END INVESTMENT COMPANY MEMBERS No. 79-12
SMALL FUNDS MEMBERS No. 40-12
INVESTMENT ADVISER MEMBERS No. 47-12 RE: CFTC STAFF ISSUES FUND OF FUNDS EXTENSION; RULE 4.5 LETTERS TO CFTC ON (1) TEMPORARY EXTENSION RELATING TO INVESTMENTS IN SECURITIZATION VEHICLES AND (2) APPLICATION OF THE CFTC'S DISCLOSURE RULES TO FUNDS WITHIN SERIES COMPANIES

The staff of the Commodity Futures Trading Commission ("CFTC" or "Commission") has just issued an extension from the obligation to register as a commodity pool operator ("CPO") for operators of fund of funds. [1] The relief is not self-executing, but requires filing a claim with the CFTC, which will be effective upon filing. We are in the process of reviewing the no-action relief, but wanted to distribute it immediately for your information.

Below, we briefly describe two letters recently submitted to the CFTC relating to compliance with amended CFTC Rule 4.5 and to the Commission's pending proposal on harmonization. [2] Both letters are attached to this memorandum.

Temporary Extension Relating to Investments in Securitization Vehicles

ICI and other trade associations [3] have jointly submitted a letter to the CFTC requesting a 9-month temporary exclusion from including investments in securitization vehicles as "commodity interests" for purposes of commodity pool operator ("CPO") and commodity trading advisor ("CTA") registration and compliance.

As we have previously explained, the CFTC generally treats an investment by a registered investment company ("fund") or a private fund in another collective investment vehicle that engages in commodity interest transactions to be the same as a direct allocation of assets to trading commodity interests for purposes of determining whether the fund or private fund is "operated for the purpose of trading in commodity interests," and thus constitutes a commodity pool. As of January 1, 2013, swaps must be included as commodity interests. Although the CFTC recently provided guidance that "equity REITs," as well as securitization vehicles that operate consistent with the conditions set forth in Regulation AB or Rule 3a-7 under the Investment Company Act of 1940 and meet certain other conditions, will not be considered to be commodity pools, [4] this leaves other REITs and securitization vehicles, as well as other collective investment vehicles, potentially within the commodity pool classification. Accordingly, in determining whether it may rely on CFTC Rule 4.5 or Rule 4.13(a)(3), the operator of a registered investment company or private fund that invests in other collective investment vehicles may need to take into account commodity interests entered into by (1) REITs that are not exempt under Staff Letter 12-13, (2) securitization vehicles that are not exempt under Staff Letter 12-14, or (3) other collective investment vehicles, unless and until the CFTC provides further relief in this area.

The joint letter requests temporary relief from considering investment in securitization vehicles for purposes of determining whether an entity must register as a CPO or CTA because of the significant uncertainty that exists at this time pending the CFTC's issuance of fund of funds guidance and any further relief or guidance that may be issued in this area. While this letter focuses on securitization vehicles, it notes that the same concerns exist with respect to investments in foreign REITs and mortgage REITs.

CFTC Disclosure Rules and Their Application to Funds Within Series Companies

As we previously informed you, the CFTC staff has indicated informally that funds organized in series form would be required to include all funds in a series company in a single prospectus, even if only a single fund is unable to rely on amended Rule 4.5. ICI has submitted a letter to the CFTC outlining our serious concerns with this staff position. The letter explains that the separateness of each fund in a series company is well established under law, and that the CFTC itself has applied the Rule 4.5 exclusion on a fund by fund basis. It also discusses how the staff position, if endorsed by the CFTC, would raise significant public policy concerns, including lengthy and unnecessary disclosure, investor confusion, regulatory ambiguity with regard to a fund's use of a summary prospectus, the costs and burdens associated with changed procedures for disclosure updates and possible fund reorganizations, and additional burdens on the staffs of the National Futures Association and Securities and Exchange Commission. For all of these reasons, the letter asks the CFTC to confirm that funds unable to rely on amended Rule 4.5 that are part of a

series company will be permitted to use stand-alone or combined prospectuses, a position that would harmonize the SEC and CFTC disclosure regimes for such companies.

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Attachment

endnotes

[1] The CFTC staff letter is available at http://www.cftc.gov/PressRoom/PressReleases/pr6435-12.

[2] Harmonization of Compliance Obligations for Registered Investment Companies Required to Register as Commodity Pool Operators, 77 Fed. Reg. 11345 (Feb. 24, 2012).

[3] The other signatories are the Managed Funds Association, Investment Adviser Association, and the Asset Management Group of the Securities Industry and Financial Markets Association.

[4] CFTC Letter No. 12-13 (Oct. 11, 2012); CFTC Letter No. 12-14 (Oct. 11, 2012).