The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 27569

September 17, 2013

ICI Submits Follow-Up Letter TO CFTC Staff Regarding Certain SEC Exemptive orders and No-Action Letters; NFA Makes Amended Compliance Rule 2-45 Effective

[27569]

September 17, 2013

TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 80-13
COMPLIANCE MEMBERS No. 40-13
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 71-13
INVESTMENT ADVISER MEMBERS No. 63-13
SEC RULES MEMBERS No. 87-13
SMALL FUNDS MEMBERS No. 53-13 RE: ICI SUBMITS FOLLOW-UP LETTER TO CFTC STAFF REGARDING CERTAIN SEC EXEMPTIVE ORDERS AND NO-ACTION LETTERS; NFA MAKES AMENDED COMPLIANCE RULE 2-45 EFFECTIVE

On September 16, ICI submitted a letter to the staff of the Commodity Futures Trading Commission ("CFTC") to provide additional information regarding ICI's prior request for confirmation that transactions and arrangements permitted by exemptive orders and no-action letters issued by the Securities and Exchange Commission ("SEC" or "Commission") and its staff under Section 17 of the Investment Company Act of 1940 ("Investment Company Act") will be deemed not to implicate CFTC Regulation 4.20(c), which prohibits commingling by a commodity pool operator ("CPO") of the property of any pool it operates with the property of any other person. That letter is attached and is summarized below. In addition, on September 13, the National Futures Association ("NFA") made effective immediately the amendments to NFA Compliance Rule 2-45, which prohibits loans by a commodity pool to a CPO or other affiliated person or entity.

Letter Regarding CFTC Regulation 4.20(c)

ICI's letter addresses several issues the CFTC staff has raised with ICI since we submitted our original letter in December, 2012. [1] Specifically, the staff requested additional information about the types of arrangements for which the SEC and its staff have granted exemptive or no-action relief that could potentially implicate CFTC Regulation 4.20(c), and

the parameters under which the SEC and its staff have granted such relief. The CFTC staff also asked about whether a registered investment company ("fund") that relies on an SEC exemptive order or no-action letter must disclose the terms of the relief to fund shareholders.

The letter notes that, since we submitted the December ICI Letter, the CFTC adopted final harmonization rules for operators of funds that are subject to registration as CPOs. It states that ICI's request is fully consistent with the "substituted compliance" approach taken by the CFTC in that rulemaking.

The letter discusses the purpose underlying CFTC Regulation 4.20(c), and explains that Section 17 of the Investment Company Act addresses many of the same concerns as Regulation 4.20(c), as well as more broadly prohibiting self-dealing and other forms of overreaching of a fund by its affiliates. The letter further explains the key exemptive provisions and the nature of the exemptive process under the Investment Company Act, including the relief that the SEC and its staff may provide under Section 17(d) of the Investment Company Act and Rule 17d-1 thereunder. The letter states that only the relief granted by the SEC and its staff under Section 17(d) and Rule 17d-1 permitting funds to invest in joint accounts with affiliated funds or other accounts for the limited purposes of making short-term investments appears to implicate Regulation 4.20(c). This relief is described in detail in the letter. The letter also explains that this relief generally has not included disclosure of the arrangement to shareholders, most likely because the fund's board of directors or trustees, including the independent directors or trustees, is responsible for ensuring that the joint accounts are operated in accordance with the required conditions and in the continued interests of the fund and its shareholders.

The letter concludes with a request that the CFTC staff confirm that funds engaging in such arrangements pursuant to the conditions and representations established by the SEC and its staff, including any further amendments to such relief, related staff no-action or interpretive letters, or codification of this type of relief in an SEC rule, will be deemed not to implicate CFTC Regulation 4.20(c). It further explains that, while the letter describes arrangements or transactions that potentially may implicate Regulation 4.20(c) for which the SEC and its staff have granted relief, in the future funds or their advisers may apply to the SEC for Section 17 relief for other types of arrangements or transactions that may implicate Regulation 4.20(c). The letter recommends that the CFTC staff request that a fund CPO provide notice to the CFTC staff of any exemptive application under Section 17 and Rule 17d-1 for activities that may directly implicate Regulation 4.20(c), at the time the SEC publishes notice of the application.

NFA Compliance Rule 2-45

In response to concerns raised by ICI [2] and others, last March, NFA proposed to amend Compliance Rule 2-45 [3]. Those amendments were made effective on September 13. [4] Rule 2-45, as amended, states that:

No Member CPO may permit a commodity pool to use any means to make a direct or indirect loan or advance of pool assets to the CPO or any other affiliated person or entity; provided, however, that certain specified transactions set forth in the related Interpretive Notice entitled Prohibition of Loans by Commodity Pools to CPOs and Related Entities are not prohibited by this rule.

The transactions included in the referenced Interpretive Notice specifically applicable to fund CPOs include, as requested by ICI's December letter to NFA:

> . . . certain loans or advances of fund assets pursuant to the [Investment Company Act], exemptive rules under the[Investment Company Act], exemptive orders issued by the SEC and no-action letters issued by SEC staff subject to specific conditions set forth in the rule, exemptive order or no-action letter, as applicable, that are designed to ensure that the inter-fund loans only occur in circumstances that are favorable to both funds, and not in circumstances when an affiliate might cause a fund to engage in transactions that are detrimental to the interest of one of the funds. Therefore, transactions by a pool that is also a RIC or BDC that are permitted pursuant to the ICA, exemptive rules promulgated under the [Investment Company Act], and exemptive orders issued by the SEC or no-action letters issued by SEC staff pursuant to Sections 17 or 57 of the [Investment Company Act], as applicable, do not violate NFA Compliance Rule 2-45. [5]

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Attachment

endnotes

[1] See Letter to Gary Barnett, Director, Division of Swap Dealer and Intermediary Oversight, Commodity Futures Trading Commission, from Karrie McMillan, General Counsel, Investment Company Institute, dated December 21, 2012 (“December ICI Letter”).

[2] See Letter to Daniel A. Driscoll, Executive Vice President, Chief Operating Officer, and Thomas W. Sexton, III, Senior Vice President, General Counsel and Secretary, National Futures Association, from Karrie McMillan, General Counsel, ICI, dated Dec. 21, 2012 (“December Letter to NFA”).

[3] See Letter to Mr. Christopher Kirkpatrick, Deputy Secretary, Office of the Secretariat, Commodity Futures Trading Commission, from Thomas W. Sexton, Senior Vice President and General Counsel, National Futures Association, dated Mar. 4, 2013, available at http://www.nfa.futures.org/news/PDF/CFTC/CR2-45_InterpNotc_ProhibitLoansByCommodityPoolsToCPOs_022113.pdf.

[4] See Amended Compliance Rule 2-45, available at http://www.nfa.futures.org/nfamanual/NFAManual.aspx?RuleID=RULE%202-45&Section=4.

[5] NFA Interpretive Notice 9062, Prohibition of Loans by Commodity Pools to CPOs and Related Entities, available at http://www.nfa.futures.org/nfamanual/NFAManual.aspx?RuleID=9062&Section=9.

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