The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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April 25, 2012

ICI Files Comment Letter and Cost-Benefit Analysis on CFTC Rule 4.5 Harmonization Proposal

[26083]

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TO: ACCOUNTING/TREASURERS MEMBERS No. 8-12
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UNIT INVESTMENT TRUST MEMBERS No. 3-12
VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 3-12 RE: ICI FILES COMMENT LETTER AND COST-BENEFIT ANALYSIS ON CFTC RULE 4.5 HARMONIZATION PROPOSAL

ICI has filed a comment letter with the Commodity Futures Trading Commission ("Commission" or "CFTC") on its proposal ("Proposal") to "harmonize" certain aspects of its regulatory regime with existing regulatory requirements applicable to investment companies registered under the Investment Company Act of 1940 ("registered investment companies" or "funds"), as administered by the Securities and Exchange Commission ("SEC"). [1] ICI's comment letter, along with the cost-benefit analysis ICI prepared on the Proposal, is attached and is summarized briefly below.

The comment letter begins by reiterating ICI's strong objections to the CFTC's amendments to Rule 4.5 under the Commodity Exchange Act ("CEA"), and states that ICI and the U.S. Chamber of Commerce have filed a lawsuit challenging the CFTC's adoption of Rule 4.5. The letter explains that the Proposal fails to deliver on the Commission's stated intention to

minimize the burden of the amendments to Rule 4.5, and that the Proposal would do great harm by essentially nullifying the SEC's efforts over the past 30 years to make fund disclosure clear, concise, and therefore more useful to investors. It also describes how the Proposal would impose extremely burdensome, costly, and unnecessary reporting requirements on funds and their advisers.

The letter urges the CFTC to assess the vast amount of information that funds and their advisers already provide to the SEC and investors. It asserts that such an examination will demonstrate that the Commission's stated objective—of having "adequate information . . . to effectively oversee [funds'] derivatives trading activities"—would be met by accepting the forms that funds already file with the SEC.

The comment letter also argues that, if the CFTC concludes that SEC filings by funds and advisers do not provide it with adequate information about funds' derivatives trading, the Commission should explain what information is missing, why the information is necessary, propose tailored requirements designed to obtain such information in a manner that does not interfere with current SEC requirements, and provide interested parties with the opportunity to comment on those specific proposals. Alternatively, the CFTC should engage in a true harmonization effort jointly with the SEC. Such an effort by the two agencies should include developing an integrated disclosure document for funds advised by registered commodity pool operators ("CPOs") that is focused on the informational needs of investors in such funds, as well as disclosure filing and review, reporting, and recordkeeping requirements and procedures designed to provide effectively and efficiently both regulators with the information they need to conduct the appropriate oversight.

The letter also identifies several specific areas of concern for advisers unable to rely on amended Rule 4.5 and the funds they manage. These issues are insufficiently addressed (or not addressed at all) by the Proposal. They include, among others, the presentation of prior performance information, certain fees and expenses, risk disclosures, the use of the summary prospectus, registration statement requirements for funds that have concluded an offering of shares, underlying funds for variable insurance products, periodic reporting requirements, books and records requirements, and the costs and potential problems that would be associated with any dual review of fund disclosures by the National Futures Association and the SEC.

The comment letter states that the CFTC has not properly considered the costs of the Proposal, and that the Commission's cursory cost-benefit analysis significantly underestimates the potential costs and burdens of the Proposal for advisers that will be unable to rely on amended Rule 4.5 and the funds they manage. The letter asserts that the Commission's flawed cost-benefit analysis would not satisfy the requirements of the CEA or the Administrative Procedure Act, and the Commission may not finalize the Proposal without reproposing it with a proper cost-benefit analysis, subject to public notice and comment. The letter summarizes and attaches ICI's own cost-benefit analysis, which was based on a detailed survey of ICI members regarding the costs of compliance with the disclosure and reporting requirements that would apply under the Proposal. ICI's cost-benefit analysis found, among other things, a cost to those responding to the survey of $21.7 million to comply initially and an additional $10.9 million to comply on an annual ongoing basis, for just the disclosure and reporting requirements discussed in the Proposal. [2] It explains that these costs could be as high as $50 million initially and $25 million on an annual ongoing basis for the industry as a whole, if funds whose advisers did not respond to the survey have the same incidence of triggering the requirement to register as a CPO as those whose advisers did respond.

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Senior Counsel

Attachment

endnotes

[1] For a summary of the Proposal, please see ICI Memorandum No. 25889 (February 10, 2012).

[2] The cost-benefit analysis was not intended to, and does not, capture all of the costs associated with the amendments to Rule 4.5.