

MEMO# 26599

October 23, 2012

ICI and Chamber of Commerce File Supplemental Brief in Lawsuit Challenging Amendments to Rule 4.5

[26599]

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TO: BOARD OF GOVERNORS No. 12-12
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SMALL FUNDS MEMBERS No. 34-12
UNIT INVESTMENT TRUST MEMBERS No. 10-12
VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 15-12 RE: ICI AND CHAMBER OF COMMERCE FILE SUPPLEMENTAL BRIEF IN LAWSUIT CHALLENGING AMENDMENTS TO RULE 4.5

Yesterday, ICI and the U.S. Chamber of Commerce filed a supplemental brief in their lawsuit against the Commodity Futures Trading Commission (CFTC). The brief follows the CFTC's supplemental brief in the lawsuit, which was filed with the court on October 15. [\[1\]](#) ICI's brief addresses the implications of the recent D.C. District Court decision vacating the CFTC's position limits rule (ISDA Decision) [\[2\]](#) for CFTC Rule 4.5, which cross-references the definitions of "bona fide hedging" included in the now-invalidated position limits rule. The brief is attached to this memorandum and is summarized below.

The brief states that there is no question that the ISDA Decision vacated new CFTC Rule 151.5, as well as the CFTC's amendments to Rule 1.3(z)(1), the two definitions of bona fide hedging that are incorporated by reference in Rule 4.5. It explains that the commitment in the no-action letter by the CFTC staff to not recommend enforcement action if funds rely on the definitions of bona fide hedging that were vacated by the ISDA Decision [\[3\]](#) "does not change the fact that [Rule] 4.5 specifically incorporates one provision that no longer exists because it was vacated by this Court, as well as a second provision that was significantly

amended in the now-vacated rulemaking.” The brief also explains that the no-action letter provides no relief for entities that qualify for the bona fide hedging exemption under the previous version of Rule 1.3(z)(1), but would not qualify under amended Rule 1.3(z)(1) or Rule 151.5. The brief states that, for these entities, “the letter is not a promise of non-enforcement; it is a threat to apply a more restrictive definition of bona fide hedging than the definition now on the books after the ISDA decision.” The brief argues that, furthermore, the no-action letter purports only to bind one Division of the CFTC and not the CFTC itself, and might not bar lawsuits under the Commodity Exchange Act’s private right of action. The brief asserts that, even if the letter were broader, the CFTC “cannot re-write its regulations through a staff letter; the reference to the now-vacated provisions remains unaltered in the Code of Federal Regulations.”

The brief asserts that the CFTC’s reliance in its Rule 4.5 rulemaking on a now-vacated definition of bona fide hedging requires that Rule 4.5 be vacated. The brief describes several ways in which reliance on the now-vacated definitions has resulted in a flawed cost-benefit analysis.

The brief also asserts that the uncertainty created by the invalidation of amended Rule 1.3(z)(1) and Rule 151.5 is further reason that the court should vacate Rule 4.5. It notes that the CFTC staff no-action letter does nothing to eliminate the uncertainty that will be created by the cross-reference in Rule 4.5 to a now-vacated rule. It states that the CFTC compounded this confusion by issuing a rule release the day after filing its supplemental brief that treats amended Rule 1.3(z)(1) as if it were never vacated. Finally, the brief notes the additional uncertainty created by the CFTC’s apparent position, as expressed in the lawsuit, and contrary to the language in its rulemaking release, that the requirement to file Form CPO-PQR under CFTC Rule 4.27 will become effective immediately upon registration as a commodity pool operator, rather than 60 days following the conclusion of the harmonization rulemaking.

We now await Judge Howell’s decision in the case.

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[Attachment](#)

endnotes

[1] See ICI Memorandum No. 26588 (October 16, 2012), available at http://www.ici.org/my_ici/memorandum/memo26588.

[2] International Swaps and Derivatives Association, et al. v. United States Commodity Futures Trading Commission, Case No. 11-cv-2146 (D.D.C. September 28, 2012).

[3] See Division of Swap Dealer and Intermediary Oversight, Interpretation of Bona Fide Hedging in Commission Regulation 4.5: Restatement of Terms Incorporated by Reference, CFTC Letter No. 12-19 (October 12, 2012).

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