

MEMO# 4305

December 7, 1992

INSTITUTE COMMENT LETTER ON PROPOSED AMENDMENTS TO SECTION 4.5

December 7, 1992 TO: CLOSED-END FUND COMMITTEE NO. 31-92 SEC RULES COMMITTEE NO. 91-92 RE: INSTITUTE COMMENT LETTER ON PROPOSED AMENDMENTS TO CFTC REGULATION 4.5

As we previously informed you, the Commodity Futures Trading Commission recently proposed amendments to Regulation 4.5 under the Commodity Exchange Act, which provides an exclusion from the definition of "commodity pool operator" under that Act for certain otherwise regulated entities such as registered investment companies. (See Memorandum to Closed-End Fund Committee No. 27-92 and SEC Rules Committee No. 83-92, dated November 2, 1992.) The proposed amendments are intended to expand the ability of qualified entities to engage in commodity futures and commodity options transactions without being required to register with the CFTC. The Institute has filed a comment letter with the CFTC generally supporting the proposal, but suggesting certain modifications. A copy of the Institute's comment letter on the proposed amendments is attached. Under the current rule, entities wishing to qualify for the exclusion must file a notice with the CFTC containing certain representations. Among these are a representation that the entity will use commodity futures or commodity options solely for "bona fide hedging" purposes, or in accordance with an alternative test in the case of certain long positions. The Institute's comment letter commends the CFTC for recognizing that the current provision is unduly restrictive, and for seeking to accomplish the objectives of Section 4.5 in "a more 'strategy neutral' way." As noted in the comment letter, the Institute had proposed similar changes to Section 4.5 in a January 1991 letter to the CFTC (a copy of which is attached to the comment letter). With respect to the specific provisions of the proposed amendments, the Institute's letter suggests certain changes to the proposed new "market exposure" test under the rule. As proposed by the CFTC, that test would permit an eligible entity to engage in commodity futures and commodity options transactions that do not constitute bona fide hedging or meet the existing alternative test under the rule, as long as the collective market exposure attained through such transactions does not predominate the total market exposure of the entity's portfolio. The Institute's comment letter proposes that investment companies relying on the market exposure test not be subject to the two other quantitative trading restraints contained in the proposal, i.e., the requirement to set aside cash and/or short-term debt securities with respect to positions entered into under the market exposure test and a 5% limit on the amount of initial margin and premiums paid in connection with such positions. Frances M. Stadler Assistant Counsel Attachment

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