asset management group

January 25, 2013

VIA ELECTRONIC MAIL

Mr. Gary Barnett
Director
Division of Swap Dealer and Intermediary Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Compliance with Registration Requirements Under Amended Regulations 4.5 and 4.13(a)(3)

Dear Mr. Barnett:

The Investment Company Institute,[1] the Investment Adviser Association,[2] the Managed Funds Association,[3] and the Asset Management Group of the Securities Industry and Financial

[1] The Investment Company Institute ("ICI") is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $13.9 trillion and serve over 90 million shareholders. As a result of the CFTC's recent amendments to Regulation 4.5, many registered investment advisers that advise registered investment companies must register as commodity pool operators. Although ICI has judicially challenged amended Regulation 4.5, see Complaint, Investment Company Institute, et al. v. CFTC, Case No. 1:12-cv-00612 (D.D.C. Apr. 17, 2012), it is committed to assisting its members' efforts to comply with the amended regulation.

[2] The Investment Adviser Association ("IAA") is a not-for-profit association that represents the interests of investment adviser firms registered with the Securities and Exchange Commission. Founded in 1937, the IAA's membership consists of more than 550 advisers that collectively manage in excess of $10 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations. For more information, please visit our web site: www.investmentadviser.org.

[3] The Managed Funds Association ("MFA") represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital

Markets Association[4] respectfully request that the Division of Swap Dealer and Intermediary Oversight ("DSIO" or the "Division") of the Commodity Futures Trading Commission (the "Commission" or "CFTC") grant relief to permit sponsors of registered investment companies ("registered funds") and privately offered investment funds ("private funds," together with registered funds, "funds") to net certain uncleared swaps held by a fund when applying the net notional test in amended Regulation 4.5 or 4.13(a)(3), as applicable.[5] As discussed briefly below, we believe that such relief would be consistent with the intent of these regulations (i.e., to limit use of commodity interests by funds operated by persons excluded from the definition of commodity pool operator ("CPO") or exempt from CPO registration) without thwarting the policy goals underlying the regulations.

To rely on amended Regulation 4.5 or 4.13(a)(3), a fund must satisfy one of two trading thresholds. One of those thresholds, known as the net notional test, requires that the aggregate net notional value of the fund's commodity interest positions, determined at the time the most recent position was established, does not exceed 100 percent of the liquidation value of the fund's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into.[6] Each regulation, along with the existing staff guidance,[7] permits netting of (1) futures contracts and options with the same underlying commodity across designated contract markets and foreign boards of trade and (2) swaps cleared on the same derivatives clearing organization where appropriate. Neither regulation, however, explicitly permits the netting of uncleared swaps.

We respectfully request that the DSIO grant relief that would permit a fund to net uncleared swaps for purposes of the net notional test provided that (1) the termination dates of the offsetting swaps are the same and (2) the reference asset or rate for the offsetting swaps is the

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markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

[4] The Asset Management Group ("AMG") of the Securities Industry and Financial Markets Association's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 pension funds and private funds such as hedge funds and private equity funds.

[5] *Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations*, 77 Fed. Reg. 11252 (Feb. 24, 2012) ("Adopting Release"); *correction notice published at* 77 Fed. Reg. 17328 (Mar. 26, 2012).

[6] Amended Regulation 4.5 permits the operator of a registered fund to exclude *bona fide* hedging positions (within the meaning and intent of Regulations 1.3(z)(1) and 151.5), but Regulation 4.13(a)(3) does not.

[7] *See Division of Swap Dealer and Intermediary Oversight Responds to Frequently Asked Questions – CPO/CTA: Amendments to Compliance Obligations* (August 14, 2012, as amended) (answer to question 3 under the heading "Trading Limits").

same. Such netting should be permitted regardless of whether the counterparties to the offsetting swaps are identical as the purpose of the *de minimis* limitations is to limit commodity interest exposure.[8] We also request that the relief make clear that, if the notional amounts of the offsetting swaps are not the same, the amount netted should be equal to the smaller of the two notional amounts. In these circumstances, the offsetting swaps serve to reduce the fund's exposure to commodity interests, which is fully consistent with the purpose of the trading thresholds in Regulations 4.5 and 4.13(a)(3).

Without the requested relief, both the long exposure and the short exposure on offsetting swaps would have to be counted for purposes of the net notional test. This would overstate the fund's actual exposure to the underlying commodity interests.[9] We recognize that a fund could terminate the swap to avoid this overcounting. We have learned from our members, however, that this approach would cause two additional problems, which ultimately would increase costs for or otherwise disadvantage fund investors.

First, terminating the swap is likely to be more costly than entering into an offsetting position. In this case, an existing counterparty would charge a termination fee that could be greater than the cost of entering into an offsetting transaction with the same or a different counterparty. As a result, the fund is likely to receive less favorable execution than if it were able to consider terms for an offsetting position from multiple counterparties. The regulations should not create an incentive for a fund to deal with only one (and perhaps a more expensive) counterparty solely because of regulatory benefits from dealing with that counterparty over others.

Second, terminating the swap would cause the fund to realize gain or loss for tax purposes earlier than would be required if an offsetting swap is entered into. In addition, except to the extent the straddle rules apply, it may cause a fund to realize short term gain rather than long term gain (which is currently taxed at a lower rate), which would reduce the returns for fund investors.

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[8] *See* Adopting Release, *supra* note 5, at 11256 (noting that the purpose of the trading limitations is to limit a fund's exposure to commodity interests).

[9] By way of illustration, assume a fund has a long uncleared swap with a termination date of March 31, 2013 with counterparty A. The fund manager wants to roll over that swap, so the manager obtains competitive bids and determines it would be in the best interests of the fund to roll the swap forward with counterparty B instead of counterparty A. To accomplish this, the manager could enter into a short uncleared swap on the same reference asset or rate with the same termination date (March 31, 2013) with counterparty B, and also enter into a new long swap on the same reference asset or rate with a later termination date also with counterparty B. In such circumstances, until the first termination date (March 31, 2013 in this example) has passed, the manager may need to count all three swaps in calculating the fund's compliance with the net notional test in Regulations 4.5 and 4.13(a)(3), thus overstating the fund's actual exposure to the reference rate or asset. When the manager enters into the offsetting swap and the new swap with counterparty B, it reduces the spread that counterparty B charges for the positions and therefore gives the fund a better overall execution price for the rollover than if the manager had entered into the offsetting swap with counterparty A and the new swap with counterparty B.

For the reasons discussed in this letter, we believe it would be appropriate for the DSIO to allow the operator of a fund to net its uncleared swaps as outlined above when calculating the net notional test under amended Regulation 4.5 or 4.13(a)(3), as applicable.

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We appreciate the Division's prompt consideration of this request. If you have questions or require further information, please contact ICI (Karrie McMillan at 202/326-5815, Sarah A. Bessin at 202/326-5835 or Rachel H. Graham at 202/326-5819), IAA (Karen L. Barr at 202/293-4222), MFA (Stuart Kaswell or Jennifer Han at 202/730-2600), or SIFMA AMG (Tim Cameron at 212/313-1389).

Sincerely,

/s/Karrie McMillan

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cc: Amanda Olear, Special Counsel
Michael W. Ehrstein, Attorney – Advisor
Division of Swap Dealer & Intermediary Oversight, CFTC