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November 26, 2012

Daniel A. Driscoll
Executive Vice President and Chief Operating Officer

Thomas W. Sexton, III
Senior Vice President, General Counsel and Secretary

National Futures Association
300 S. Riverside Plaza, #1800
Chicago, Illinois 60606-6615

Re: Compliance with NFA Bylaw 1101

Dear Messrs. Driscoll and Sexton,

Earlier this year, the Commodity Futures Trading Commission ("CFTC") amended its Regulation 4.5 to require investment advisers to certain registered investment companies ("registered funds") to register as commodity pool operators ("CPOs") and become members of the National Futures Association ("NFA"). Over the past several months, the Investment Company Institute¹ has been working with its members and our counsel at K&L Gates on a wide range of issues stemming from the amendments to Regulation 4.5, including determining how advisers to registered funds will comply with applicable NFA rules.²

To this end, members of my staff, together with Cary Meer and Larry Patent of K&L Gates, participated in a conference call with you and other NFA staff on August 14. It is my understanding that one of the issues discussed was how advisers to registered funds (that cannot rely on amended Regulation 4.5) will be expected to comply with NFA Bylaw 1101 and that you indicated a willingness to receive further information from ICI that is relevant to this inquiry.

¹ The Investment Company Institute 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 \$13.5 trillion and serve over 90 million shareholders.

² 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 in the event the rule is upheld.

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Enclosed for your consideration are ICI's recommendations on how the Bylaw 1101 requirement should—and should not—be applied to advisers to registered funds that cannot rely on amended Regulation 4.5. We believe these recommendations, if adopted, would satisfy the regulatory purpose of the Bylaw 1101 requirement without unduly burdening registered funds, their advisers, and their investors.

If you have questions or would like to discuss our recommendations, please contact me at 202/326-5815, Sarah A. Bessin at 202/326-5835 or Rachel H. Graham at 202/326-5819.

Sincerely,



Karrie McMillan
General Counsel

Enclosure

cc: Carol Wooding, NFA
Regina Thoele, NFA
Mary McHenry, NFA
Cary Meer, K&L Gates
Larry Patent, K&L Gates

Compliance with NFA Bylaw 1101

NFA Bylaw 1101 states: “No Member may carry an account, accept an order or handle a transaction in commodity futures contracts for or on behalf of any non-Member of NFA, or suspended Member, that is required to be registered with the Commission as an FCM, IB, CPO, CTA or LTM, and that is acting in respect to the account, order or transaction for a customer, commodity pool or participant therein, a client of a commodity trading adviser, or any other person [unless the non-Member/suspended Member meets certain conditions].”

The investment adviser CPO (“fund adviser”) to a registered investment company unable to rely on CFTC Rule 4.5 (“fund”) would be able to comply with Bylaw 1101 with regard to:

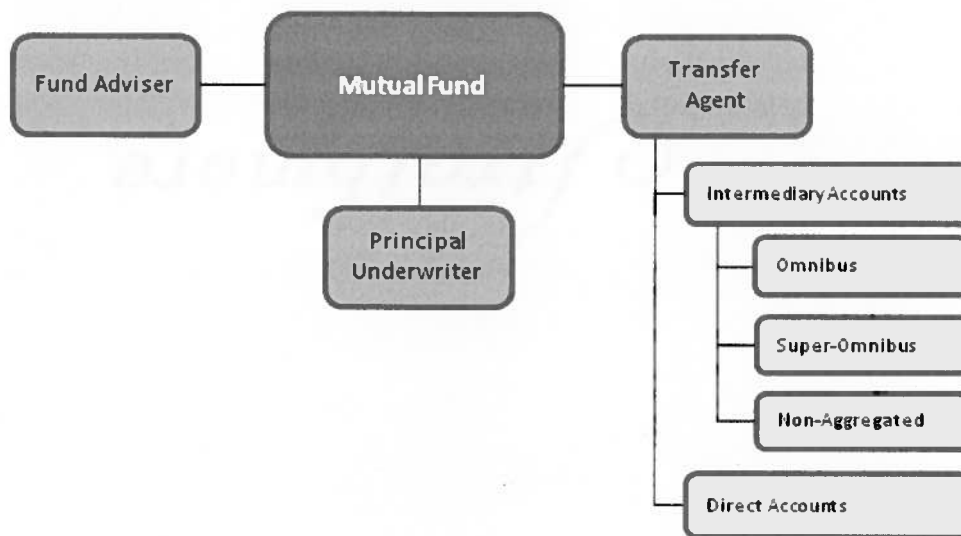
- Any futures commission merchant (“FCM”) through which the fund adviser purchases or sells commodity futures or options contracts for the fund’s account.
 - To comply with Bylaw 1101, the fund adviser would need to confirm the FCM’s status as a CFTC registrant before engaging in transactions through that FCM.
- Any subadviser that provides investment management services to the fund.
 - A fund adviser may provide all investment management services to the fund, or it may delegate responsibilities to one or more subadvisers. As required by the Investment Company Act of 1940, the contract between the fund adviser and a subadviser (or among the fund adviser, subadviser and fund) must be approved by the fund’s board of directors.
 - The fund adviser is expected to conduct due diligence on the subadviser and present its recommendation to the fund board.¹
 - To comply with Bylaw 1101, the fund adviser would need to confirm that the subadviser is either registered with the CFTC as a commodity trading advisor (“CTA”) if necessary and a member of NFA, or is exempt from registration as a CTA.²

¹ See Independent Directors Council, *Board Oversight of Subadvisers* (Jan. 2010), at 6. The report is available at http://www.idc.org/pdf/idc_10_subadvisers.pdf.

² Whether a subadviser is registered as a CTA can be easily determined by using the BASIC system function on the NFA website. If the subadviser is relying on one of the statutory exemptions in Sections 4m(1) or 4m(3) of the Commodity Exchange Act, no filing with the NFA or the CFTC is required, and thus the fund adviser would need to obtain a representation from the subadviser.

The fund adviser would not, however, perform any due diligence with regard to investors in the fund or the financial intermediaries through which investors may acquire fund shares. As a threshold matter, we do not believe Bylaw 1101 would require such efforts. In particular, the fund adviser does not accept orders for fund shares.³ Fund distribution and related recordkeeping functions are instead handled by the fund’s principal underwriter and transfer agent, respectively. Indeed, as illustrated by Figure 1 below, the fund adviser does not have a direct business relationship with investors in the fund or the financial intermediaries through which investors may acquire fund shares.⁴

Figure 1



Even if Bylaw 1101 were deemed to apply to the fund adviser vis a vis the investors in a fund, it would be wholly impractical for the fund adviser to satisfy that obligation. This is due to the sheer number and complexity of investor account structures and the difficulties that would be encountered in identifying (and then checking the registration status of) the hundreds or thousands of intermediaries that could be associated with a fund’s accounts, as discussed in more detail below.

³ Likewise, the fund adviser does not “carry” the fund on its balance sheet or “handle a transaction in commodity futures contracts” for or on behalf of an entity required to be registered with the CFTC that is acting on behalf of a customer.

⁴ A fund is typically sponsored by its investment adviser, which is also responsible for providing portfolio management services. The fund’s principal underwriter (also known as the fund’s distributor) purchases shares from the fund and resells them to the investing public. The fund’s transfer agent (which may or may not be affiliated with the fund adviser) performs all recordkeeping on behalf of the fund. Each of these service providers—the investment adviser, principal underwriter and transfer agent—serves pursuant to contract with the fund, and those contracts must be approved annually by the fund’s board of directors. For more information on the organization of a fund, *see* 2012 Investment Company Fact Book, http://www.ici.org/pdf/2012_factbook.pdf, at 199.

- Most investors acquire fund shares through a financial representative that is associated with a broker-dealer, bank, trust, retirement plan or other institutional platform (collectively, Intermediary Accounts, as noted in Figure 1). ICI research shows that 69 percent of mutual fund-owning households own mutual funds (the most common type of registered investment company) through an employer-sponsored retirement plan, and 80 percent of investors who own mutual funds outside of such a plan purchased their shares through an intermediary. Other investors may be serviced directly by the fund's transfer agent (Direct Accounts, as noted in Figure 1).
- Investor information for Direct Accounts is maintained on the books and records of the fund's transfer agent. The same level of transparency does not exist for fund investors that are serviced through Intermediary Accounts, which typically are registered with the fund's transfer agent in one of three ways:
 - **Omnibus accounts** represent the accounts of multiple investors that are customers of the intermediary. The fund's transfer agent does not know the individual identity or specific transaction activities of each underlying investor. Transactions are typically aggregated, netted, and transmitted by the intermediary via the omnibus account. By way of example, an omnibus account could be registered as "ABC LLC FBO (for the benefit of) XYZ" (where ABC is a brokerage firm and XYZ is a profit sharing plan) or simply "ABC LLC." If the intermediary is a small firm or sole proprietorship, the name on the omnibus account – for example, "James Smith LLC" – may not give sufficient clues as to the type of account or involvement of an intermediary.
 - **Super-Omnibus accounts** are heterogeneous omnibus accounts that represent a mix of the intermediary's customers, such as individual investors, plus other omnibus account holders with the intermediary (*e.g.*, retirement plans or other pooled accounts). The fund's transfer agent does not know the individual identity or specific transaction activities of each underlying investor, and may not even know that the account is super-omnibus. By way of example, a super-omnibus account could be registered as "ABC LLC FBO its customers" or simply "ABC LLC."
 - **Non-Aggregated or "individual" accounts** are registered in the name of an intermediary for the benefit of the investor. The fund's transfer agent knows the investor's transactional history, but may or may not know the investor's identity. By way of example, a non-aggregated account could be registered as "ABC LLC FBO John Doe" or, most common, "ABC LLC FBO 14576" (where 14576 is ABC's internal account number for its customer John Doe). Depending upon the transfer agent's recordkeeping system, it may or may not be clear whether an intermediary is holding the account for an investor (here, for John Doe) or whether the account registered to the intermediary is omnibus or super-omnibus.

- The typical fund is broadly distributed and will have many thousands of fund investor accounts and intermediary relationships. For the very largest funds, investor accounts may number in the millions—on a *per fund* basis.
- A requirement that a fund adviser review all investor accounts or even just the CFTC/NFA registration status of the intermediaries associated with omnibus and super-omnibus accounts (to the extent those intermediaries can be identified) would be an enormous undertaking. As illustrated above, the account name alone might not give sufficient clues as to the account type or involvement of an intermediary, and so this review would not be a simple matter of “eyeballing” a list of fund accounts. In large measure, this review would be a labor-intensive, highly- *manual* process involving multiple entities and can rightly be compared to looking for a needle in a haystack. Finally, the costs of this undertaking would be paid by the fund and, ultimately, its investors.

* * * * *

We accordingly ask NFA to confirm that fund advisers should comply with Bylaw 1101 with regard to (1) any FCM through which the fund adviser purchases or sells commodity futures or options contracts for the fund’s account and (2) any subadviser that provides investment management services to the fund. We further ask NFA to confirm that fund advisers would not be required to perform any due diligence with regard to investors in the fund or the financial intermediaries through which investors may acquire fund shares. As explained above, we do not believe Bylaw 1101 would require such efforts. Even if it did, such efforts would be wholly impractical and unlikely to be conclusive; their costs, moreover, would be borne by fund investors.