INVESTMENT COMPANY INSTITUTE

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September 28, 2017

Mr. Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Project KISS (RIN 3038-AE55)

Dear Mr. Kirkpatrick:

The Investment Company Institute[1] commends the Commodity Futures Trading Commission for undertaking its "Project Kiss" initiative to determine how the Commission's rules, regulations, or practices can be applied in a simpler, less burdensome manner.[2] ICI and its members have a strong interest in the CFTC and its staff rationalizing CFTC rules to reduce unnecessary burdens on market participants, particularly by recognizing the critical differences between registered investment companies ("registered funds") and traditional participants in the commodity markets. As participants in the derivatives markets, registered funds support regulation designed to maintain orderly, competitive, and efficient derivatives markets. Derivatives are a particularly useful portfolio management tool in that they offer registered funds considerable flexibility in structuring their investment portfolios.[3]

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[1] ICI is a leading global association of regulated funds, including mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$20.4 trillion in the United States, serving more than 95 million US shareholders, and US$6.7 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

[2] *Project Kiss*, 82 Fed.Reg. 23765 (May 24, 2016), *available at* http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2017-10622a.pdf.

[3] A registered fund uses derivatives, among other things, to hedge positions, equitize cash, adjust the duration of its portfolio, and generally manage the portfolio in accordance with the investment objectives stated in its prospectus.

Registered funds are subject to CFTC regulation in two separate capacities. First, funds are buy-side participants in the derivatives market and are subject to rules such as the clearing mandate and the trading obligation. Second, registered funds are subject to CFTC regulation as a result of the CFTC's 2012 amendments to Regulation 4.5 under the Commodity Exchange Act (CEA), which required many registered fund advisers to register with the CFTC as commodity pool operators (CPOs).

We welcome this opportunity to provide our recommendations as the Commission reconsiders the application of its rules. We believe our recommendations are consistent with the agenda Chairman Giancarlo recently articulated for the CFTC,[4] particularly his goals of:

- Reducing regulatory burden, consistent with President Trump's executive orders;[5]
- Returning the CFTC to "regular order," and
- Resetting the CFTC's focus on its core mission, including leveraging its cooperation with parallel federal market regulators such as the Securities and Exchange Commission.

We recognize that some of our recommendations may, or would, require the Commission to engage in rulemaking. We discuss those issues in our letter, however, because we believe they are critical issues for the Commission's further consideration, and hope this discussion will be the beginning of a further and more in-depth dialogue.

We have organized our recommendations, below, according to each of the topics on which the Commission seeks comment.[6] For your convenience, our attached recommendations are summarized briefly below:

- **The CFTC should amend Regulation 4.5 to eliminate unnecessary regulatory overlap for registered funds and their advisers.** The CFTC should amend the rule to exclude registered funds advisers from being treated as CPOs, just as they were immediately prior to the rule's 2012

[4] Acting Chairman J. Christopher Giancarlo, *CFTC: A New Direction Forward, Remarks before the 42nd Annual International Futures Industry Conference,* Boca Raton, Florida (March 15, 2017), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-20.

[5] *See* Exec. Order, Reducing Regulation and Controlling Regulatory Costs (Jan. 30, 2017), *available at* https://www.whitehouse.gov/the-press-office/2017/01/30/presidential-executive-order-reducing-regulation-and-controlling; *see also* Exec. Order, Enforcing the Regulatory Reform Agenda (Feb. 24, 2017), *available at* https://www.whitehouse.gov/the-press-office/2017/02/24/presidential-executive-order-enforcing-regulatory-reform-agenda.

[6] Consistent with the electronic filing requirements, we are filing this cover letter, along with an Appendix that corresponds to the topic of the respective Commission filing portal (registration, reporting, clearing, executing). *See* https://comments.cftc.gov/KISS/KissInitiative.aspx.

amendments.

- **Until the CFTC amends Regulation 4.5, it should take a substituted compliance approach to regulating registered fund CPOs and CTAs.** We suggest that the CFTC and its staff take a pragmatic, outcomes-based substituted compliance approach to addressing regulatory overlap for registered fund CPOs and CTAs in areas that were not adequately addressed by harmonization, and take such an approach as new issues arise in the future. We provide, as examples, Forms CPO-PQR and CTA-PR, liquidation statements, and recordkeeping.

- **The CFTC should adopt its rulemaking proposal that would provide relief to CPOs and CTAs acting on behalf of non-US persons.** We urge the CFTC promptly to adopt its 2016 rulemaking proposal that would, among other things, amend Regulation 3.10(c)(3) to eliminate unnecessary conditions, consistent with prior staff no-action relief.

- **The CFTC should amend its definition of "US person" to exclude certain non-US funds**. For purposes of the cross-border application of the CFTC's swaps provision, the CFTC should exclude from its definitions of "US person" non-US regulated funds that are authorized to be publicly offered to non-US persons but are not offered publicly to US persons.

- **The CFTC should retain the strong asset protections for cleared swaps provided by the "LSOC" model.** As the CFTC considers any recommendations for reform it may receive in the clearing area, we urge it to retain the "legal segregation with operational commingling," or LSOC, model for the protection of customer collateral and extend these protections to other cleared derivatives.

- **The CFTC should strengthen the process for making a swap "available to trade."** The CFTC should engage in a rulemaking that would address the risks and weaknesses inherent in the current "made available to trade," or MAT, process. We recommend that this process ensure that only those swaps that are liquid enough to support mandatory execution on a swap execution facility or designated contract market become MAT.

We also share Chairman Giancarlo's interest in reforming the CFTC's swap trading rules to foster a vibrant and liquid swaps market. To that end, we are preparing a separate letter—that we expect to submit soon—which will contain a set of recommendations designed to improve swaps trading.

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We appreciate the Commission's consideration of our recommendations. If you have questions or require further information, please contact me at (202) 218-3563, Sarah Bessin at (202) 326-5835, Jennifer Choi at (202) 326-5876, or Rachel Graham at (202) 326-5819.

Sincerely,

/s/ Dorothy M. Donohue

Dorothy M. Donohue
Acting General Counsel

cc: The Honorable J. Christopher Giancarlo
The Honorable Brian D. Quintenz
The Honorable Rostin Benham

Matthew B. Kulkin, Director
Division of Swap Dealer and Intermediary Oversight
Commodity Futures Trading Commission

Thomas W. Sexton, III, President and CEO
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Appendix: Registration Recommendations

Recommendation 1: The CFTC Should Amend Regulation 4.5 to Eliminate Unnecessary Regulatory Overlap for Registered Funds

Background: In 2012, the CFTC amended Regulation 4.5 under the Commodity Exchange Act (CEA), as part of a rulemaking that was not mandated (or even contemplated) by the Dodd-Frank Act.[1] From the adoption of Regulation 4.5 in 1985 until passage of the 2012 amendments, all entities subject to the rule—registered funds, insurance company separate accounts, bank trust and custodial accounts, and retirement plans subject to ERISA fiduciary rules—were accorded equal treatment. Following the amendments, however, only registered funds were obligated to comply with certain trading[2] and marketing conditions in order to continue to rely on the Regulation 4.5 exclusion.[3] If a registered fund is unable to satisfy these conditions, its adviser must register as a CPO.

While the CFTC's stated intent, in amending Regulation 4.5, was to target "de facto" commodity pools, the amendments instead have had a sweeping effect on the registered fund industry, forcing many advisers to SEC-registered funds to register with the CFTC as CPOs, even though many of them do not offer funds that remotely resemble, or compete with, traditional commodity pools. The Regulation 4.5 amendments have affected even those fund advisers that have not had to register as CPOs because of

[1] *Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations*, 77 Fed. Reg. 11252 (Feb. 24, 2012); *correction notice published at* 77 Fed. Reg. 17328 (Mar. 26, 2012) (collectively, "Regulation 4.5 Adopting Release").

[2] To rely on Regulation 4.5, a registered fund adviser must satisfy either of two trading thresholds: (1) the fund's aggregate initial margin and premiums required to establish positions in commodity futures, commodity options contracts, or swaps (exclusive of (i) trading for "*bona fide* hedging" and (ii) the amount by which an option is in-the-money) does not exceed five percent of the liquidation value (*i.e.*, NAV) of the fund's portfolio after taking into account unrealized profits and losses on such positions, or (2) the aggregate net notional value of positions in commodity futures, commodity option contracts, or swaps (exclusive of trading for *bona fide* hedging purposes) does not exceed 100 percent of the liquidation value of the fund's portfolio after taking into account unrealized profits and losses on any such positions.

[3] A registered fund adviser also must satisfy a marketing condition to rely on the Regulation 4.5 exclusion, which requires that the adviser not market participations in the fund to the public as a commodity pool or "vehicle for trading in the commodity futures, commodity options, or swaps markets." The CFTC has stated that the following factors are relevant in determining whether a fund is unable to satisfy the marketing condition: (i) name of the fund; (ii) whether the fund's primary investment objective is tied to a commodity index; (iii) whether the fund makes use of a controlled foreign corporation for its derivatives trading; (iv) whether the fund's marketing materials, including its prospectus or disclosure document, refer to the benefits of the use of derivatives in a portfolio or make comparisons to a derivatives index; (v) whether, during the course of its normal trading activities, the fund or entity on its behalf has a net short speculative exposure to any commodity through a direct or indirect investment in other derivatives; (vi) whether the futures/options/swaps transactions engaged in by the fund or on behalf of the fund will directly or indirectly be its primary source of potential gains and losses; and (vii) whether the fund is explicitly offering a managed futures strategy. Regulation 4.5 Adopting Release, *supra* note 1, at 11259.

the need to monitor their portfolios and activities on an ongoing basis to ensure their ability to rely on Regulation 4.5 exclusion, regardless of whether a fund actively trades commodity interests.

Thus, the CFTC's amendments to Regulation 4.5 have had broad implications for the registered fund industry, and have imposed significant additional compliance costs and burdens on the industry and on fund shareholders. These costs and burdens include:

- For fund advisers that seek to rely on the Regulation 4.5 exclusion, the need to monitor their funds' portfolio composition, trading, and marketing activities on an ongoing basis to ensure they do not exceed the rule's thresholds, even if a fund does not actively trade commodity interests. The parameters of the rule's conditions, particularly the marketing conditions, have proved to be ambiguous, and CFTC staff guidance has been limited, making compliance challenging.[4]

- For fund advisers that must register as CPOs and CTAs, complying with CFTC and National Futures Association (NFA) requirements that overlap with SEC requirements to which registered funds and their advisers already are subject. Many of these rules are intended to accomplish similar regulatory objectives, yet impose different and additional obligations on registered funds and their advisers.

The CFTC, in 2013, adopted rules to "harmonize" its requirements with those of the SEC.[5] While the harmonization rulemaking was helpful in some respects, it failed to adequately address concerns about

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[4] The CFTC and its staff have interpreted *bona fide* hedging in an ambiguous manner that has focused primarily on transactions that normally represent a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel. This approach is not readily applicable to hedging strategies utilized by registered funds in the financial markets. *See, e.g.,* CFTC Letter 12-19 (Oct. 12, 2012), *available at* http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/12-19.pdf. For example, advisers to registered funds frequently manage fund assets so that they replicate or exceed the performance of a benchmark (or a group of benchmarks) and will use commodity interests to manage their cash so that it replicates the performance of the benchmark. The industry does not believe that this activity is "speculative" because it merely causes the fund's assets to track the performance of the relevant benchmark (which is what the investors expect). This activity may not be treated as *bona fide* hedging for purposes of Regulation 4.5, however, unless most of the commodity interest positions are unwound and actual securities are purchased. Mutual funds may not favor this strategy, however, as it could increase transaction costs and impair their portfolio and liquidity risk management techniques.

Furthermore, in the Regulation 4.5 Adopting Release, the CFTC provided a broadly-worded list of factors for applying the marketing test that has resulted in a lack of clarity for the registered fund industry regarding which activities would cause a registered fund adviser to be unable to rely on the exclusion. *See supra* note 1. Marketing factor (vi), which references the fund's future source of direct or indirect gains and losses, has proven particularly challenging to apply, as it is impossible to predict accurately, particularly when a fund is initially established, what the fund's source of gains and losses will be over the life of the fund. In addition, to the extent the adviser uses commodity interests to hedge the fund's exposure, the adviser cannot predict whether the hedge will produce the gain and the underlying will produce losses, or vice versa, and it seems inappropriate to base the need for CPO registration on the performance of a hedge.

[5] *Harmonization of Compliance Obligations for Registered Investment Companies Required To Register as Commodity Pool Operators*, 78 Fed.Reg. 52308 (Aug. 22, 2013) ("Harmonization Adopting Release").

regulatory overlap between the CFTC and SEC with respect to registered funds and their advisers. Experience with harmonization over the past several years has revealed fundamental shortcomings in this approach, which further support the need for the CFTC to amend Regulation 4.5 to exclude registered fund advisers. For example:

- The harmonization rulemaking was not sufficiently comprehensive. It failed to provide relief with respect to several key substantive areas in which registered fund CPOs remain subject to costly overlapping regulation.[6] That rulemaking also failed to provide any relief to registered fund CTAs, or address the unnecessary costs and burdens to registered fund CPOs and CTAs created by overlapping NFA regulation.

- In areas where the CFTC failed to fully harmonize its regulations with those of the SEC, the CFTC's approach has often not adequately taken into account the critical differences between registered funds and traditional commodity pools, resulting in regulatory requirements that are unnecessarily burdensome or do not make sense when applied to registered funds and their advisers.[7]

- The harmonization rulemaking did not adequately consider existing SEC requirements. For example, when the CFTC adopted Form CPO-PQR, it did not evaluate the reporting requirements to which registered funds and their advisers already were subject – it simply subjected registered fund CPOs to the new reporting requirements.[8]

- The CFTC's approach to harmonization does not have a mechanism to account for changes to SEC regulation. For example, the SEC recently broadened its reporting requirements for both registered funds and advisers.[9] The CFTC has not analyzed the extent to which CFTC reporting requirements under CPO-PQR and CTA-PR overlap with SEC reporting requirements under Forms N-PORT, N-CEN, and ADV. These overlapping reporting requirements will impose significant unnecessary regulatory burdens and costs on registered funds and their advisers, with many of these costs being indirectly borne by fund shareholders.

There is no evidence that the CFTC's overlapping regulation of registered funds and their advisers is necessary, or has produced any discernible benefit to fund shareholders. Registered funds and their

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[6] These areas include, among others, regulatory reporting, pool liquidation statements, recordkeeping, and regulation of certain fund transactions.

[7] Please see, for example, our discussion of pool liquidations and recordkeeping, *infra*.

[8] Harmonization Adopting Release, *supra* note 5, at 52312.

[9] *See Investment Company Reporting Modernization*, 81 Fed. Reg. 81870 (Nov. 18, 2016) ("Investment Company Reporting Adopting Release"); *Form ADV and Investment Advisers Act Rules*, 81 Fed. Reg. 60418 (Sept. 1, 2016) ("ADV Adopting Release"). These enhanced reporting requirements are subject to phased in compliance dates beginning October 2017 for the Form ADV amendments and June 2018 for the enhanced fund reporting requirements.

advisers already are extensively regulated under the federal securities laws.[10] And, in recent years, the SEC has taken steps to further enhance this regulatory scheme. It has adopted regulations that will enhance the information reported by registered funds, including with respect to their derivatives holdings.[11] The SEC also proposed a rule that would update and codify requirements applicable to registered funds' use of derivatives.[12]

Unfortunately, fund shareholders indirectly bear most of the costs of the CFTC's overlapping regulation—Americans investing for their retirement, education, and other important savings goals. This unnecessary regulation also has imposed a regulatory cost on the CFTC by straining the already limited resources of the agency, and diverting resources from the agency's core mission at a time that the Commission seeks to refocus on that core mission. It has imposed a similar cost on the NFA, which has been burdened with a host of new responsibilities as a result of the 2012 amendments.

Recommendation: The CFTC should amend Regulation 4.5 to exclude registered funds and their advisers from being treated as CPOs, just as they were immediately prior to the 2012 amendments. Amending the rule in this manner would further Chairman Giancarlo's goal of right-sizing the CFTC's regulatory footprint, by focusing on the CFTC's core mission, and working cooperatively with other regulators, such as the SEC.[13] Eliminating unnecessary regulatory overlap with the SEC of registered funds and their advisers would relieve registered funds and their shareholders of the unnecessary burdens and costs that the CFTC's rulemaking has imposed, without undermining investor protection. The SEC would continue to regulate all registered funds and their advisers comprehensively, while key CFTC rules would continue to govern registered funds whenever they trade in commodity interests.[14]

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[10] These include the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, the Investment Advisers Act of 1940, and the rules thereunder. These laws and rules include, among other provisions: (i) limits on the use of leverage (including leverage through the use of derivatives); (ii) antifraud provisions; (iii) comprehensive disclosure to investors; (iv) comprehensive regulatory reporting; (v) independent board oversight; (vi) restrictions on transactions involving conflicts of interest; (vii) requirements regarding custody of fund assets; and (viii) fidelity bonding of certain fund officers.

[11] Investment Company Reporting Adopting Release, *supra* note 9.

[12] *See Use of Derivatives by Registered Investment Companies and Business Development Companies*, 80 Fed. Reg. 80884 (Dec. 28, 2015).

[13] Acting Chairman J. Christopher Giancarlo, *CFTC: A New Direction Forward, Remarks before the 42nd Annual International Futures Industry Conference,* Boca Raton, Florida (March 15, 2017), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-20 ("A New Direction Forward").

[14] Key CFTC rules would continue to govern registered funds when they trade in the commodity markets. These include, for example, the anti-manipulation provisions of the CEA, the CFTC's "large trader" reporting rules, as well as the swap data reporting rules required by the Dodd-Frank Act. *See* Sections 6(c) and 9(a)(2) of the CEA; 17 C.F.R. Parts 15-21 (market and large trader reporting rules); *Swap Data Recordkeeping and Reporting Requirements*, 77 Fed. Reg. 2136 (Jan. 13, 2012); *Real Time Public Reporting of Swap Transaction Data*, 77 Fed. Reg. 1182 (Jan. 9, 2012).

Recommendation 2: Until the CFTC Amends Regulation 4.5, It Should Take a Substituted Compliance Approach to Regulating Registered Fund CPOs and CTAs

Background: In August 2013, approximately eighteen months after the CFTC adopted the Regulation 4.5 amendments, the CFTC finalized a related rulemaking to "harmonize" its requirements with those of the SEC.[15] The final harmonization rulemaking acknowledged the robustness of the SEC regulatory regime for registered funds. On this basis, the final rule takes a "substituted compliance" approach — that is, it exempts registered fund advisers subject to the CFTC's jurisdiction from certain CFTC regulations on the basis that adherence to the SEC's rules generally "should provide market participants and the public with meaningful disclosure … provide the [CFTC] with information necessary to its oversight … and ensure that [registered fund advisers] maintain appropriate records regarding their operations."[16] Regrettably, however, the CFTC's harmonization rulemaking did not provide relief with respect to several key substantive areas in which registered fund CPOs remain subject to costly, duplicative regulation. Nor did it provide any relief for registered fund CTAs, which may serve as subadvisers to registered funds that are subject to CFTC regulation.[17] It also left registered fund CPOs and CTAs subject to the compliance rules of the NFA, in addition to SEC and CFTC rules, resulting in significant regulatory overlap.

Recommendation: Until the CFTC amends Regulation 4.5 as we suggest, we recommend that the Commission and its staff take a pragmatic, outcomes-based substituted compliance approach[18] to addressing regulatory overlap for registered fund CPOs and CTAs in areas that were not adequately addressed by harmonization, and take such an approach as new issues arise in the future.[19] A substituted compliance approach to the regulation of registered fund CPOs and CTAs is consistent with the CFTC's acknowledgement in its 2013 harmonization rulemaking of the robustness of the

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[15] *See* Harmonization Adopting Release, *supra* note 5.

[16] *Id.*

[17] *See Division of Swap Dealer and Intermediary Oversight Responds to Frequently Asked Questions – CPO/CTA: Amendments to Compliance Obligations* (Aug. 14, 2012), which postponed the recordkeeping, reporting, and disclosure compliance obligations for registered fund CTAs until "60 days following the effective date of a final rule implementing the Commission's proposed harmonization effort." Unfortunately, despite the FAQs' suggestion that relief for CTAs might have been forthcoming, the Harmonization Adopting Release did not provide any relief for registered fund CTAs.

[18] Chairman Giancarlo has described his recommended approach to international engagement as comity, not uniformity, noting that "[t]he CFTC should move to a flexible, outcomes-based approach for cross-border equivalence and substituted compliance." *See* A New Direction Forward, *supra* note 13, at 3. Similarly, in utilizing a substituted compliance approach in regulating registered fund CPOs and CTAs, the CFTC's goal should not be uniformity, but comparable regulatory outcomes.

[19] As appropriate, this may include CFTC rulemaking, written CFTC or staff guidance, or "frequently asked questions." We urge the CFTC and its staff, before issuing guidance or FAQs to provide an opportunity for formal or informal public comment, to ensure that any guidance or FAQs will be workable. In addition, any guidance or FAQs should be publicly available in writing to ensure consistency.

SEC regulatory regime for registered funds.[20] Permitting registered fund CPOs and CTAs to satisfy their CFTC and NFA obligations through substituted compliance would eliminate the duplicative regulation to which these entities currently are subject, and thereby would lower some of the costs and regulatory burdens amended Regulation 4.5 has imposed on registered funds and their shareholders. This approach would further Chairman Giancarlo's goals of reducing excessive regulatory burdens, increasing the Commission's ability to focus on its core mission, and leveraging existing regulation by other regulators, such as the SEC.[21] Substituted compliance would accomplish these objectives with no loss of protection for investors and the markets.[22]

It is critical that registered fund CTAs also receive substituted compliance relief. The SEC's rules under the Investment Company Act of 1940 and the Investment Advisers Act of 1940 do not distinguish between registered fund advisers and sub-advisers — they are each treated as an "adviser" and subject to registration and regulation under the Advisers Act. Thus, not providing relief for registered fund CTAs as we request will undercut the benefit of substituted compliance for registered funds.[23]

We note that the CFTC's undertaking a more comprehensive substituted compliance approach to the regulation of registered fund CPOs and CTAs should only be viewed as a temporary solution to this issue, and that amending Regulation 4.5, as we recommend above, is the appropriate long-term solution. First, while a substituted compliance approach has many advantages, it does not address the fundamental lack of justification for the CFTC's regulation of registered fund CPOs and CTAs. Even a substituted compliance approach still imposes considerable costs both on registered fund CPOs and CTAs, as well as the CFTC and NFA and their staffs, which still must devote a considerable amount of their limited resources to achieving substituted compliance, at the expense of their core mission. Second, registered fund advisers that are able to rely on amended Regulation 4.5, and are not required to register as CPOs, must nonetheless monitor their portfolio composition, trading, and marketing activities on an ongoing basis to ensure compliance with the amended rule, which is unnecessarily burdensome and costly.

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[20] Harmonization Adopting Release, *supra* note 5, at 52310.

[21] A New Direction Forward, *supra* note 13.

[22] For similar reasons, we recommend that the CFTC direct the NFA to take a substituted compliance approach with respect to the regulation of registered fund CPOs and CTAs. Although NFA has taken a substituted compliance approach to regulating registered fund CPOs in certain areas, registered fund CPOs and CTAs largely are still subject to regulation by NFA in areas that overlap with their regulation by the SEC, including regulatory reporting, recordkeeping, and other regulatory requirements.

[23] Advisers and subadvisers to controlled foreign corporations (CFCs) of registered funds similarly should receive substantive compliance relief. A CFC typically is established as a wholly-owned subsidiary of a registered fund. The SEC staff requires registered funds employing a subsidiary structure to operate the subsidiary in conformity with the key substantive provisions of the Investment Company Act, notably Section 8 (investment policies), Section 17 (affiliated transactions and custody requirements) and Section 18 (capital structure and leverage). Without substituted compliance for the operators of and advisers to CFCs, much of the benefit of substituted compliance will be lost.

Specific examples of areas in which a substituted compliance approach should be applied include, but are not limited to, periodic reporting to regulators on Forms CPO-PQR and CTA-PR, pool liquidation statements, and recordkeeping. Harmonization did not adequately address any of these areas.

Periodic Reporting to Regulators

Registered funds are subject to comprehensive reporting requirements under SEC rules. For example, funds are required to report extensive information about their portfolio holdings to the SEC, as well as information about the fund's investment policies and practices, fees and expenses, and other matters.[24] The SEC recently enhanced these reporting obligations to require funds to report additional information on Forms N-PORT and N-CEN, including detailed information about derivatives holdings, fund investment practices, portfolio characteristics, and risk metrics.[25] Registered investment advisers are required to report detailed information about their businesses to the SEC on Form ADV, including information about the funds they manage and, pursuant to a recent rulemaking, data regarding any separately managed accounts.[26] Together, these SEC reporting requirements provide a holistic picture of the adviser and its investment activities.

Much of the information that the SEC requires registered funds and their advisers to report on these forms overlaps with information the CFTC requires on Forms CPO-PQR and CTA-PR. For example, both SEC and CFTC rules require registered funds to report detailed information about fund portfolio holdings, portfolio characteristics, and risk metrics. Both SEC and CFTC rules require registered advisers to report information about the funds and accounts they manage, including data about fund and account holdings. While in some instances, the SEC and CFTC require slightly different information, both rule sets are intended to accomplish similar regulatory objectives. In the absence of substituted compliance, registered fund sponsors must develop systems to source, compile, and report multiple sets of very similar information to comply with these rules and report similar, but sometimes slightly different, information for the same entity. This is costly, burdensome, unnecessary, and inefficient.

We therefore recommend that the CFTC permit registered fund CPOs and CTAs to satisfy their obligation to file Form CPO-PQR and CTA-PR by filing SEC Forms N-PORT, N-CEN, and Form ADV.[27] A substituted compliance approach to reporting would provide the CFTC with comparable

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[24] *See* SEC Forms N-CSR, N-Q, and N-SAR.

[25] Investment Company Reporting Adopting Release, *supra* note 9. Form N-CEN replaced and updated existing SEC Form N-SAR. Form N-PORT replaced Form N-Q, and will require monthly reporting of a fund's portfolio holdings data.

[26] *See* ADV Adopting Release, *supra* note 9.

[27] We note that registered fund CPOs also are required to file NFA Forms PQR and PR. We recommend that the CFTC direct the NFA to take a substituted compliance approach with respect to the regulation of registered fund CPOs and CTAs, including with respect to regulatory reporting. *See supra* note 22.

data about registered funds and their advisers, without imposing undue burdens and costs on registered funds and their shareholders.

Pool Liquidations

CFTC Regulation 4.22(c) addresses the annual report requirements applicable to registered CPOs ("Annual Report"). The rule provides that, if a pool ceases trading, the CPO may, in lieu of the full Annual Report, provide a "liquidation statement" to the NFA and pool participants that includes audited financial statements, unless the CPO obtains waivers from pool participants.

When the CFTC issued the harmonization rulemaking in 2013, it provided in the adopting release that a registered fund CPO could satisfy its obligation to file an Annual Report by filing with NFA the financial statements the fund files with the SEC.[28] The harmonization rulemaking, however, did not explicitly address how a registered fund CPO should comply with the "liquidation statement" requirement under Regulation 4.22(c). The CFTC staff subsequently took the view that registered fund CPOs are subject to the liquidation statement requirement with respect to each series of a registered fund that is liquidating.[29]

Registered funds already are subject to SEC requirements and safeguards that address the same concerns as the CFTC's liquidation statement requirement, but better reflect the structure of registered funds and the nature of their operations. For example, the SEC requires funds: (1) to be governed by a board of directors that typically consists of a majority of independent directors; (2) that offer redeemable securities (e.g., mutual funds) to publish their net asset value on a daily basis; (3) to file and send their shareholders annual audited financial statements, as well as semi-annual financial statements and quarterly statements of portfolio holdings; (4) to report information regarding funds that have liquidated on SEC Form N-CEN, as well as report on a monthly basis certain information reflecting liquidations on SEC Form N-PORT. These requirements all serve to safeguard registered fund shareholders in the event of a fund liquidation and ensure that the SEC and fund shareholders have sufficient information regarding the liquidation and the value of remaining assets in the portfolio.

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[28] "The final rule requires that operators of RICs file annual financial statements with the NFA, pursuant to the terms of § 4.22(c), which is applicable to all CPOs. It permits operators of RICs to file the same financial statements that it [sic] prepares for its compliance obligations with the SEC." Harmonization Adopting Release, *supra* note 5, at 52325.

[29] Many registered investment companies are organized as a single corporation or trust that has multiple "series," each of which represents an interest in a separate pool of securities with separate and segregated assets, liabilities, and shareholders. The CFTC staff has stated that when the corporation or trust (rather than the series) that is registered as an investment company liquidates, the CFTC will accept, as substituted compliance with the liquidation statement requirement, the registered fund's filing with the SEC of SEC Form N-8F, which provides details regarding the liquidation. *See* CFTC Letter 17-04 (Jan. 26, 2017), *available at* http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/17-04.pdf.

Although the CFTC staff issued an exemption earlier this year that provides relief to registered fund CPOs with respect to the rule's audit requirement,[30] it is of limited value to registered fund CPOs because they still must undergo the unnecessary burden and expense of preparing financial statements for a liquidating fund, costs which are deducted from remaining fund assets that otherwise would be paid to shareholders. We therefore urge the CFTC to apply a substituted compliance approach and permit registered fund CPOs to satisfy the liquidation statement requirement of Regulation 4.22(c) by complying with relevant SEC requirements.

Recordkeeping[31]

The CFTC's harmonization rulemaking also did not adequately address regulatory overlap with respect to recordkeeping requirements for registered fund CPOs or CTAs. While the harmonization rulemaking provided limited relief from specified recordkeeping requirements applicable to registered fund CPOs (and no relief for registered fund CTAs),[32] it failed to acknowledge that registered funds and their advisers are subject to extensive recordkeeping obligations under the Investment Company Act and the Advisers Act with respect to the maintenance of a broad range of books and records.[33] The CFTC did not provide substituted compliance relief to registered fund CPOs or CTAs in the harmonization rulemaking either with respect to the content of the records required to be maintained under CFTC regulations, or the manner in which such records must be maintained. As a result, registered fund CPOs and CTAs are subject to overlapping recordkeeping regimes.[34]

The SEC's recordkeeping requirements serve the same purposes as, and in some respects are more extensive than, those set forth in the CFTC recordkeeping rules that apply to CPOs and CTAs. Imposing two overlapping recordkeeping regimes on registered funds is burdensome and costly to fund shareholders, and provides no discernible benefit.

We therefore urge the CFTC to adopt a substituted compliance approach to recordkeeping for registered fund CPOs and CTAs.[35] We discuss these recommendations in more detail in the comment

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[30] *See* CFTC Letter No. 17-04 (Jan. 26, 2017), *available at* http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/17-04.pdf.

[31] We acknowledge that this recommendation may require the Commission to engage in rulemaking to implement.

[32] *See* Harmonization Adopting Release, *supra* note 5, at 52321.

[33] The Investment Company Act does not distinguish between advisers and subadvisers to registered funds. They are subject to equivalent regulation under the Investment Company Act and under the Advisers Act (as they must be registered under both laws to advise a registered fund).

[34] Registered fund CPOs and CTAs also are subject to NFA's recordkeeping regulations.

[35] To be sufficiently comprehensive, this relief should extend to registered fund advisers that rely on the CFTC's Regulation 4.5 exclusion, those that rely on an exemption or exclusion from CTA registration, along with third parties that hold required records on behalf of registered fund CPOs and CTAs, or any of these other entities.

letter ICI filed with the CFTC[36] in connection with the CFTC's recent rulemaking regarding Regulation 1.31.[37]

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[36] Letter to Mr. Christopher Kirkpatrick, Secretary, Commodity Futures Trading Commission, from David W. Blass, General Counsel, Investment Company Institute, dated March 20, 2017, *available at* https://www.ici.org/pdf/30649a.pdf.

[37] *Recordkeeping,* 82 Fed.Reg. 24479 (May 30, 2017). Our recommendations, which the Commission declined to accept, were based on a rulemaking petition ICI filed with the Commission in 2014. *See* Petition for Rulemaking to Amend CFTC Regulations 4.12(c)(3), 4.23 and 4.33, by Investment Company Institute, dated March 11, 2014, *available at* https://www.ici.org/pdf/27946.pdf.

Recommendation 3: The CFTC Should Adopt Its Proposal to Codify No-Action Relief for CPOs and CTAs Acting on Behalf of Non-US Persons

Background: Regulation 3.10(c)(3)(i) currently provides an exemption from registration as a CPO, CTA, or introducing broker (IB) if a person and the transaction meet the following conditions: (i) the person is located outside the United States; (ii) the person acts only on behalf of persons located outside the United States; and (iii) the commodity interest transaction is submitted for clearing through a registered futures commission merchant (FCM).[38] The CFTC staff has granted no-action relief that permits CTOs, CTAs, and IBs, acting solely on behalf of persons located outside the United States, to rely on Regulation 3.10(c)(3)(i), even if they do not satisfy the clearing requirement because their activities involve swaps that are not subject to a Commission clearing requirement.[39] Similarly, the CFTC staff has granted no-action relief under Regulation 3.10(c)(3) from the requirement to register as an IB or CTA in connection with transactions for certain international financial institutions (IFIs)[40] with respect to swaps, even if the clearing requirement is not met.[41]

Last year, the Commission proposed to amend Regulation 3.10(c)(3) to codify and expand this no-action relief by eliminating from Regulation 3.10(c)(2)(i) and (3)(i) both the clearing requirement and references to designated contract markets (DCMs) and SEFs.[42] The proposed amendments also would broaden the exemption to extend to activity that is either solely on behalf of "foreign located persons" or IFIs (both of which would be defined under the rule).

Recommendation: We urge the Commission promptly to adopt its 2016 proposal.[43] The proposal is consistent with the underlying purposes, goals, and intent of Regulation 3.10(c)(3)(i), as well as the goals of Project KISS and the broader priorities Chairman Giancarlo recently articulated for the CFTC.[44] In particular, as the Commission acknowledges, the proposed amendments would enhance protection of market participants "by providing greater legal certainty . . ." as well as "greater efficiency,

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[38] Rule 3.10(c)(2)(i) provides a similar exemption from registration for a person acting as an FCM.

[39] *See* CFTC No-Action Letter 16–08 (Feb. 12, 2016).

[40] IFIs are those institutions defined in the Commission's previous rulemakings and staff no-action letters including, but not limited to, the International Monetary Fund, the International Bank for Reconstruction and Development, and the European Bank for Reconstruction and Development.

[41] *See* CFTC No-Action Letter 15-37 (June 4, 2015).

[42] *Amendment to Commission Regulation 3.10(c): Exemption from Registration for Certain Foreign Persons*, 81 Fed. Reg. 51824 (Aug. 5, 2016) ("Rule 3.10(c)(3) Proposal").

[43] *See* Letter to Mr. Christopher J. Kirkpatrick, Secretary, Commodity Futures Trading Commission, from Robert C. Grohowski, General Counsel, Investment Adviser Association; Timothy W. Cameron, Esq., Managing Director, Asset Management Group – Head, Securities Industry and Financial Markets Association; Dan Waters, Managing Director, ICI Global; et al., dated Sept. 6, 2016, *available at* https://www.iciglobal.org/pdf/30209.pdf.

[44] *See* A New Direction Forward, *supra* note 13.

competitiveness and financial integrity of financial markets; price discovery; and sound risk management practices by ensuring greater depth in swaps markets accessed by U.S. persons."[45] The proposal also is consistent with Chairman Giancarlo's priority of seeking cross-border comity, because it recognizes that when a foreign CPO's or foreign CTA's "customers are located outside the U.S., the jurisdiction where the customer is located has the preeminent interest in protecting such customers."[46]

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[45] Rule 3.10(c)(3) Proposal, *supra* note 42.

[46] *Id.*

Recommendation 4: The CFTC Should Amend Its Definition of "US Person" to Exclude Certain Non-US Funds

Background: Section 2(i) of the CEA excludes from its scope all swap activities outside the United States, unless those activities have a "direct and significant connection with activities in, or effect on, commerce of the United States." The Commission issued interpretive guidance in 2013 to clarify its cross-border policy applicable to swap transactions.[47] That guidance defined "US person," identifying persons that the CFTC deemed to meet the jurisdictional nexus to the United States under Section 2(i). To ensure that foreign funds with only a nominal nexus to the United States were not subject to the CFTC's regulations, the guidance specifically excluded from the "US person" definition, among others, non-US regulated funds that are publicly offered to non-US persons but not offered to US persons (e.g., UCITS).[48]

The "US person" definitions in recent CFTC rulemakings have not contained a similar exclusion, which could unnecessarily cause non-US regulated funds with little or no connection to the United States to go through a complicated analysis to determine whether they are US persons and must comply with CFTC regulations.[49] Specifically, without an explicit exclusion, foreign funds, such as UCITS, that have a US manager would have to make a facts and circumstances determination as to whether they have "a principal place of business in the United States" and are a "US person," even though the risks of those funds' transactions reside outside the United States, and investors have no reasonable expectation that US laws would apply to them.

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[47] *Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations*, 78 Fed.Reg. 45291 (July 26, 2013), *available at* http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-17958a.pdf.

[48] UCITS or "undertakings for collective investment in transferable securities" are funds established and authorized under a harmonized European Union (EU) legal framework. UCITS sponsors establish and authorize a UCITS in one EU Member State and can sell the UCITS in other EU Member States without requiring an additional full registration. UCITS are subject to detailed requirements including those related to disclosure and custody, as well as investment restrictions and limitations. UCITS are required to have a European primary manager that remains fully responsible for management of the fund, although the primary manager may appoint a subadviser.

[49] *See, e.g.*, *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross Border Application of the Margin Requirements*, 81 Fed.Reg. 34818 (May 31, 2016) (final rule), available at: https://www.gpo.gov/fdsys/pkg/FR-2016-05-31/pdf/2016-12612.pdf; *Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants*, 81 Fed.Reg. 71946 (Oct. 18, 2016) (proposed rule), available at https://www.gpo.gov/fdsys/pkg/FR-2016-10-18/pdf/2016-24905.pdf. *See also* Letter to Mr. Christopher J. Kirkpatrick, Secretary, Commodity Futures Trading Commission, from Dan Waters, Managing Director, ICI Global (Sept. 14, 2015), *available at* https://www.iciglobal.org/pdf/29341.pdf; Letter to Mr. Christopher J. Kirkpatrick, Secretary, Commodity Futures Trading Commission, from Dan Waters, Managing Director, ICI Global (Dec. 19, 2016), *available at* https://www.ici.org/pdf/30486a.pdf.

We believe the lack of a clear exclusion for foreign regulated funds that are authorized to be publicly offered to non-US persons but are not publicly offered to US persons imposes burdens and costs that are not necessary for the protection of US investors or US markets. First, in the absence of an explicit exclusion, foreign regulated funds that have a US manager may be deemed a "US person" and potentially could be subject to the conflicting rules of two separate jurisdictions – those of the fund's home jurisdiction as well as CFTC regulations, a costly and burdensome prospect. Second, non-US regulated funds may terminate a US asset manager and/or avoid hiring a US asset manager, to avoid being subject to US regulation. Third, non-US dealers may seek to avoid engaging in transactions with non-US regulated funds that could be US persons to avoid having to comply with US swap regulation.

Recommendation: For purposes of the cross-border application of the CFTC's swaps provision, the CFTC should exclude from its definitions of "US person" non-US regulated funds that are authorized to be publicly offered[50] to non-US persons but are not offered publicly to US persons. Amending the definitions in this manner would further Chairman Giancarlo's goals of appropriately reducing unnecessary regulatory burdens and costs for entities, and seeking cross-border comity. This recommendation would exclude non-US regulated funds that do not have a "direct and significant connection" to the United States, and therefore present little risk to the US markets or US investors.

[50] Generally, non-US retail funds are regulated to make them eligible for sale to the retail public, even if a particular fund elects to limit its offering to institutional investors. Such funds, like US registered investment companies, typically are subject to substantive regulation in areas such as disclosure, form of organization, custody, minimum capital, valuation, and investment restrictions (e.g., leverage, types of investments or "eligible assets," concentration limits and/or diversification standards). *See, e.g., supra* note 48. Such non-US funds similarly do not raise any US jurisdictional interest, and should not be considered US persons.

Appendix: Reporting Recommendations

Reporting Recommendation: Until the CFTC Amends Regulation 4.5, It Should Take a Substituted Compliance Approach to Regulating Registered Fund CPOs and CTAs

Background: In August 2013, approximately eighteen months after the CFTC adopted the Regulation 4.5 amendments, the CFTC finalized a related rulemaking to "harmonize" its requirements with those of the SEC.[1] The final harmonization rulemaking acknowledged the robustness of the SEC regulatory regime for registered funds. On this basis, the final rule takes a "substituted compliance" approach — that is, it exempts registered fund advisers subject to the CFTC's jurisdiction from certain CFTC regulations on the basis that adherence to the SEC's rules generally "should provide market participants and the public with meaningful disclosure … provide the [CFTC] with information necessary to its oversight … and ensure that [registered fund advisers] maintain appropriate records regarding their operations."[2] Regrettably, however, the CFTC's harmonization rulemaking did not provide relief with respect to several key substantive areas in which registered fund CPOs remain subject to costly, duplicative regulation. Nor did it provide any relief for registered fund CTAs, which may serve as subadvisers to registered funds that are subject to CFTC regulation.[3] It also left registered fund CPOs and CTAs subject to the compliance rules of the NFA, in addition to SEC and CFTC rules, resulting in significant regulatory overlap.

Recommendation: Until the CFTC amends Regulation 4.5 as we suggest,[4] we recommend that the Commission and its staff take a pragmatic, outcomes-based substituted compliance approach[5] to addressing regulatory overlap for registered fund CPOs and CTAs in areas that were not adequately

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[1] *See Harmonization of Compliance Obligations for Registered Investment Companies Required To Register as Commodity Pool Operators*, 78 Fed.Reg. 52308 (Aug. 22, 2013) ("Harmonization Adopting Release").

[2] *Id.*

[3] *See Division of Swap Dealer and Intermediary Oversight Responds to Frequently Asked Questions – CPO/CTA: Amendments to Compliance Obligations* (Aug. 14, 2012), which postponed the recordkeeping, reporting, and disclosure compliance obligations for registered fund CTAs until "60 days following the effective date of a final rule implementing the Commission's proposed harmonization effort." Unfortunately, despite the FAQs' suggestion that relief for CTAs might have been forthcoming, the Harmonization Adopting Release did not provide any relief for registered fund CTAs.

[4] Please see our recommendations related to registration, which we filed concurrently with, and which also include, this recommendation.

[5] Chairman Giancarlo has described his recommended approach to international engagement as comity, not uniformity, noting that "[t]he CFTC should move to a flexible, outcomes-based approach for cross-border equivalence and substituted compliance." Acting Chairman J. Christopher Giancarlo, *CFTC: A New Direction Forward, Remarks before the 42nd Annual International Futures Industry Conference,* Boca Raton, Florida (March 15, 2017), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-20 ("A New Direction Forward"). Similarly, in utilizing a substituted compliance approach in regulating registered fund CPOs and CTAs, the CFTC's goal should not be uniformity, but comparable regulatory outcomes.

addressed by harmonization, and take such an approach as new issues arise in the future.[6] A substituted compliance approach to the regulation of registered fund CPOs and CTAs is consistent with the CFTC's acknowledgement in its 2013 harmonization rulemaking of the robustness of the SEC regulatory regime for registered funds.[7] Permitting registered fund CPOs and CTAs to satisfy their CFTC and NFA obligations through substituted compliance would eliminate the duplicative regulation to which these entities currently are subject, and thereby would lower some of the costs and regulatory burdens amended Regulation 4.5 has imposed on registered funds and their shareholders. This approach would further Chairman Giancarlo's goals of reducing excessive regulatory burdens, increasing the Commission's ability to focus on its core mission, and leveraging existing regulation by other regulators, such as the SEC.[8] Substituted compliance would accomplish these objectives with no loss of protection for investors and the markets.[9]

It is critical that registered fund CTAs also receive substituted compliance relief. The SEC's rules under the Investment Company Act of 1940 and the Investment Advisers Act of 1940 do not distinguish between registered fund advisers and sub-advisers — they are each treated as an "adviser" and subject to registration and regulation under the Advisers Act. Thus, not providing relief for registered fund CTAs as we request will undercut the benefit of substituted compliance for registered funds.[10]

We note that the CFTC's undertaking a more comprehensive substituted compliance approach to the regulation of registered fund CPOs and CTAs should only be viewed as a temporary solution to this issue, and that amending Regulation 4.5, as we recommend above, is the appropriate long-term solution. First, while a substituted compliance approach has many advantages, it does not address the fundamental lack of justification for the CFTC's regulation of registered fund CPOs and CTAs. Even

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[6] As appropriate, this may include CFTC rulemaking, written CFTC or staff guidance or "frequently asked questions." We urge the CFTC and its staff, before issuing guidance or FAQs to provide an opportunity for formal or informal public comment, to ensure that any guidance or FAQs will be workable. In addition, any guidance or FAQs should be publicly available in writing to ensure consistency.

[7] Harmonization Adopting Release, *supra* note 1, at 52310.

[8] A New Direction Forward, *supra* note 5.

[9] For similar reasons, we recommend that the CFTC direct the NFA to take a substituted compliance approach with respect to the regulation of registered fund CPOs and CTAs. Although NFA has taken a substituted compliance approach to regulating registered fund CPOs in certain areas, registered fund CPOs and CTAs largely are still subject to regulation by NFA in areas that overlap with their regulation by the SEC, including regulatory reporting, recordkeeping, and other regulatory requirements.

[10] Advisers and subadvisers to controlled foreign corporations (CFCs) similarly should receive substantive compliance relief. A CFC typically is established as a wholly-owned subsidiary of a registered fund. The SEC staff requires registered funds employing a subsidiary structure to operate the subsidiary in conformity with the key substantive provisions of the Investment Company Act, notably Section 8 (investment policies), Section 17 (affiliated transactions and custody requirements) and Section 18 (capital structure and leverage). Without substituted compliance for the operators of and advisers to CFCs, much of the benefit of substituted compliance will be lost.

a substituted compliance approach still imposes considerable costs both on registered fund CPOs and CTAs, as well as the CFTC and NFA and their staffs, which still must devote a considerable amount of their limited resources to achieving substituted compliance, at the expense of their core mission. Second, registered fund advisers that are able to rely on amended Regulation 4.5, and are not required to register as CPOs, must nonetheless monitor their portfolio composition, trading, and marketing activities on an ongoing basis to ensure compliance with the amended rule, which is unnecessarily burdensome and costly.

Specific examples of areas in which a substituted compliance approach should be applied include, but are not limited to, periodic reporting to regulators on Forms CPO-PQR and CTA-PR, pool liquidation statements, and recordkeeping. Harmonization did not adequately address any of these areas.

Periodic Reporting to Regulators

Registered funds are subject to comprehensive reporting requirements under SEC rules. For example, funds are required to report extensive information about their portfolio holdings to the SEC, as well as information about the fund's investment policies and practices, fees and expenses, and other matters.[11] The SEC recently enhanced these reporting obligations to require funds to report additional information on Forms N-PORT and N-CEN, including detailed information about derivatives holdings, fund investment practices, portfolio characteristics, and risk metrics.[12] Registered investment advisers are required to report detailed information about their businesses to the SEC on Form ADV, including information about the funds they manage and, pursuant to a recent rulemaking, data regarding any separately managed accounts.[13] Together, these SEC reporting requirements provide a holistic picture of the adviser and its investment activities.

Much of the information that the SEC requires registered funds and their advisers to report on these forms overlaps with information the CFTC requires on Forms CPO-PQR and CTA-PR. For example, both SEC and CFTC rules require registered funds to report detailed information about fund portfolio holdings, portfolio characteristics, and risk metrics. Both SEC and CFTC rules require registered advisers to report information about the funds and accounts they manage, including data about fund and account holdings. While in some instances, the SEC and CFTC require slightly different information, both rule sets are intended to accomplish similar regulatory objectives. In the absence of

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[11] *See* SEC Forms N-CSR, N-Q, and N-SAR.

[12] *See Investment Company Reporting Modernization*, 81 Fed.Reg. 81870 (Nov. 18, 2016) ("Investment Company Reporting Adopting Release"). Form N-CEN replaced and updated existing SEC Form N-SAR. Form N-PORT replaced Form N-Q, and will require monthly reporting of a fund's portfolio holdings data.

[13] *See Form ADV and Investment Advisers Act Rules*, 81 Fed.Reg. 60418 (Sept. 1, 2016) ("ADV Adopting Release"). The enhanced reporting requirements the SEC adopted in the ADV Adopting Release and the Investment Company Reporting Adopting Release are subject to phased in compliance dates beginning October 2017 for the Form ADV amendments and June 2018 for the enhanced fund reporting requirements.

substituted compliance, registered fund sponsors must develop systems to source, compile and report multiple sets of very similar information to comply with these rules and report similar, but sometimes slightly different, information for the same entity. This is costly, burdensome, unnecessary, and inefficient.

We therefore recommend that the CFTC permit registered fund CPOs and CTAs to satisfy their obligation to file Form CPO-PQR and CTA-PR by filing SEC Forms N-PORT, N-CEN, and Form ADV.[14] A substituted compliance approach to reporting would provide the CFTC with comparable data about registered funds and their advisers, without imposing undue burdens and costs on registered funds and their shareholders.

Pool Liquidations

CFTC Regulation 4.22(c) addresses the annual report requirements applicable to registered CPOs ("Annual Report"). The rule provides that, if a pool ceases trading, the CPO may, in lieu of the full Annual Report, provide a "liquidation statement" to the NFA and pool participants that includes audited financial statements, unless the CPO obtains waivers from pool participants.

When the CFTC issued the harmonization rulemaking in 2013, it provided in the adopting release that a registered fund CPO could satisfy its obligation to file an Annual Report by filing with NFA the financial statements the fund files with the SEC.[15] The harmonization rulemaking, however, did not explicitly address how a registered fund CPO should comply with the "liquidation statement" requirement under Regulation 4.22(c). The CFTC staff subsequently took the view that registered fund CPOs are subject to the liquidation statement requirement with respect to each series of a registered fund that is liquidating.[16]

Registered funds already are subject to SEC requirements and safeguards that address the same concerns as the CFTC's liquidation statement requirement, but better reflect the structure of registered funds and the nature of their operations. For example, the SEC requires funds: (1) to be governed by a board

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[14] We note that registered fund CPOs also are required to file NFA Forms PQR and PR. We recommend that the CFTC direct the NFA to take a substituted compliance approach with respect to the regulation of registered fund CPOs and CTAs, including with respect to regulatory reporting. *See supra* note 9.

[15] "The final rule requires that operators of RICs file annual financial statements with the NFA, pursuant to the terms of § 4.22(c), which is applicable to all CPOs. It permits operators of RICs to file the same financial statements that it [sic] prepares for its compliance obligations with the SEC." Harmonization Adopting Release, *supra* note 1, at 52325.

[16] Many registered investment companies are organized as a single corporation or trust that has multiple "series," each of which represents an interest in a separate pool of securities with separate and segregated assets, liabilities, and shareholders. The CFTC staff has stated that when the corporation or trust (rather than the series) that is registered as an investment company liquidates, the CFTC will accept, as substituted compliance with the liquidation statement requirement, the registered fund's filing with the SEC of SEC Form N-8F, which provides details regarding the liquidation. *See* CFTC Letter 17-04 (Jan. 26, 2017), *available at* http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/17-04.pdf.

of directors that typically consists of a majority of independent directors; (2) that offer redeemable securities (e.g., mutual funds) to publish their net asset value on a daily basis; (3) to file and send their shareholders annual audited financial statements, as well as semi-annual financial statements and quarterly statements of portfolio holdings; (4) to report information regarding funds that have liquidated on SEC Form N-CEN, as well as report on a monthly basis certain information reflecting liquidations on SEC Form N-PORT. These requirements all serve to safeguard registered fund shareholders in the event of a fund liquidation and ensure that the SEC and fund shareholders have sufficient information regarding the liquidation and the value of remaining assets in the portfolio.

Although the CFTC staff issued an exemption earlier this year that provides relief to registered fund CPOs with respect to the rule's audit requirement,[17] it is of limited value to registered fund CPOs because they still must undergo the unnecessary burden and expense of preparing financial statements for a liquidating fund, costs which are deducted from remaining fund assets that otherwise would be paid to shareholders. We therefore urge the CFTC to apply a substituted compliance approach and permit registered fund CPOs to satisfy the liquidation statement requirement of Regulation 4.22(c) by complying with relevant SEC requirements.

Recordkeeping[18]

The CFTC's harmonization rulemaking also did not adequately address regulatory overlap with respect to recordkeeping requirements for registered fund CPOs or CTAs. While the harmonization rulemaking provided limited relief from specified recordkeeping requirements applicable to registered fund CPOs (and no relief for registered fund CTAs),[19] it failed to acknowledge that registered funds and their advisers are subject to extensive recordkeeping obligations under the Investment Company Act and the Advisers Act with respect to the maintenance of a broad range of books and records.[20] The CFTC did not provide substituted compliance relief to registered fund CPOs or CTAs in the harmonization rulemaking either with respect to the content of the records required to be maintained under CFTC regulations, or the manner in which such records must be maintained. As a result, registered fund CPOs and CTAs are subject to overlapping recordkeeping regimes.[21]

The SEC's recordkeeping requirements serve the same purposes as, and in some respects are more extensive than, those set forth in the CFTC recordkeeping rules that apply to CPOs and CTAs.

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[17] *See* CFTC Letter No. 17-04 (Jan. 26, 2017), *available at* http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/17-04.pdf.

[18] We acknowledge that this recommendation may require the Commission to engage in rulemaking to implement.

[19] *See* Harmonization Adopting Release, *supra* note 1, at 52321.

[20] The Investment Company Act does not distinguish between advisers and subadvisers to registered funds. They are subject to equivalent regulation under the Investment Company Act and under the Advisers Act (as they must be registered under both laws to advise a registered fund).

[21] Registered fund CPOs and CTAs also are subject to NFA's recordkeeping regulations.

Imposing two overlapping recordkeeping regimes on registered funds is burdensome and costly to fund shareholders, and provides no discernible benefit.

We therefore urge the CFTC to adopt a substituted compliance approach to recordkeeping for registered fund CPOs and CTAs.[22] We discuss these recommendations in more detail in the comment letter ICI filed with the CFTC[23] in connection with the CFTC's recent rulemaking regarding Regulation 1.31.[24]

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[22] To be sufficiently comprehensive, this relief should extend to registered fund advisers that rely on the CFTC's Regulation 4.5 exclusion, those that rely on an exemption or exclusion from CTA registration, along with third parties that hold required records on behalf of registered fund CPOs and CTAs or any of these other entities.

[23] Letter to Mr. Christopher Kirkpatrick, Secretary, Commodity Futures Trading Commission, from David W. Blass, General Counsel, Investment Company Institute, dated March 20, 2017, *available at* https://www.ici.org/pdf/30649a.pdf.

[24] *Recordkeeping,* 82 Fed.Reg. 24479 (May 30, 2017). Our recommendations, which the Commission declined to accept, were based on a rulemaking petition ICI filed with the Commission in 2014. *See* Petition for Rulemaking to Amend CFTC Regulations 4.12(c)(3), 4.23 and 4.33, by Investment Company Institute, dated March 11, 2014, *available at* https://www.ici.org/pdf/27946.pdf).

Appendix: Clearing Recommendation

Recommendation: The CFTC Should Retain the Strong Asset Protections for Cleared Swaps Provided by the "LSOC" Model

Background: As fiduciaries to their clients, registered fund advisers seek strong protections for fund swap collateral when registered funds trade in the derivatives markets. Registered funds also must ensure that their collateral arrangements satisfy the custody restrictions of the Investment Company Act of 1940.[1] To achieve these objectives, registered funds that transact in uncleared swaps currently use tri-party arrangements to hold the collateral that they post to their counterparties. These arrangements subject their margin to neither the fraud risk of the futures commission merchant (FCM) nor fellow-customer risk. For cleared swaps, collateral of registered funds is protected from fellow-customer risk through the CFTC's "legal segregation with operational commingling," or LSOC model.[2] Consistent with the requirements of Section 724 of the Dodd-Frank Act, LSOC provides critical protections to the customer collateral of registered funds and other market participants when they post collateral with FCMs and DCOs.

Recommendation: As the CFTC considers any recommendations for reform it may receive in the clearing area, we urge the Commission to retain the LSOC model for the protection of customer collateral and extend these protections to other cleared derivatives. LSOC provides critical protections to collateral posted for cleared swap transactions by registered funds and other market participants, and thereby provides the assurance they need to utilize cleared swaps as a portfolio management tool.

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[1] Under the Investment Company Act, registered funds are required to custody their assets in accordance with Section 17 of the Investment Company Act. Nearly all registered funds use a US bank custodian for domestic securities although the Investment Company Act permits other limited custodial arrangements. In addition to Section 17, the Investment Company Act contains six separate custody rules for the different types of possible custody arrangements: Rule 17f-1 (broker-dealer custody); Rule 17f-2 (self-custody); Rule 17f-4 (securities depositories); Rule 17f-5 (foreign banks); Rule 17f-6 (futures commission merchants); and Rule 17f-7 (foreign securities depositories). Foreign securities are required to be held in the custody of a foreign bank or securities depository. Rule 17f-1 permits registered funds to use a broker-dealer custodian, but the rule imposes conditions that are difficult in practice to satisfy.

[2] *Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions*, 77 Fed. Reg. 6336 (Feb. 7, 2012), *available at* http://www.gpo.gov/fdsys/pkg/FR-2012-02-07/pdf/2012-1033.pdf. The LSOC model requires each FCM and derivatives clearing organization (DCO) to segregate on its books and records the cleared swaps of each individual customer and related collateral position. *See* 17 C.F.R. § 22.2 and 22.3 (2014). Each FCM and DCO is permitted to commingle customer collateral in one account. *See* 17 C.F.R. §22.2(c) (2014). FCMs and DCOs are also required to keep separate customer collateral from any account holding FCM or DCO property. *See* 17 C.F.R. § 22.2 and 22.3 (2014). Additionally, under the CFTC's rules, a clearinghouse may not allow the DCO to access the collateral of non-defaulting cleared swap customers to address losses of a defaulting swap customer in the event of a default of the clearing member (i.e., a "double default").

Appendix: Executing Recommendation

Recommendation: The CFTC Should Strengthen the Process for Making a Swap "Available to Trade"[1]

Background: The Dodd-Frank Act amended the Commodity Exchange Act to require that any swap subject to the clearing requirement must be executed on a swap execution facility (SEF) or a designated contract market (DCM) unless no SEF or DCM "makes the swap available to trade."[2] Based on this language, the CFTC has adopted rules setting out the process to determine when a swap is "made available to trade" (MAT).[3] The implications of the MAT determination are critical, as that process determines whether a swap will be subject to mandatory execution. If a swap is deemed "available to trade," it generally must be traded on a DCM or SEF, and nearly all bilateral trading in that swap must cease.

The current MAT process, however, is fundamentally flawed and is in critical need of reform. It provides the CFTC no meaningful role in determining which swaps will be subject to mandatory trading and turns over this process to SEFs and DCMs. The MAT process also does not adequately establish criteria to ensure that there is sufficient liquidity of the swap to trade on the SEF or DCM, or sufficient operational readiness of market participants to support mandatory trading in the swap.[4] This process fails to protect adequately against the financial incentives of DCMs and SEFs to subject a swap to mandatory trading, even when there is insufficient liquidity to support mandatory trading in that swap.

Recommendation: The CFTC should engage in a rulemaking that would address the risks and weaknesses inherent in the current MAT process. We recommend that the MAT process ensure that only those swaps that are liquid enough to support mandatory SEF or DCM execution become MAT. The process should include an assessment of the market structure to verify that it can support SEF or DCM trading of a swap, including the number of market participants presently providing liquidity on trading platforms and the capacity of these liquidity providers/makers and trading platforms to manage additional volume arising from the application of the trading mandate to the swap. The Commission should have adequate authority to ensure that a swap will be subject to mandatory SEF or DCM

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[1] We recognize that addressing this recommendation would require the Commission to engage in rulemaking.

[2] Section 2(h)(8) of the Commodity Exchange Act.

[3] *See Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available to Trade, Swap Transaction Compliance and Implementation Schedule, and Trade Execution Requirement Under the Commodity Exchange Act*, 78 Fed. Reg. 33606 (June 4, 2013).

[4] *See* Letter to Mr. Christopher Kirkpatrick, Secretary, CFTC, from David W. Blass, General Counsel, ICI, dated Aug. 17, 2015, *available at* https://www.ici.org/pdf/29262.pdf; Letter to Mr. David A. Stawick, Secretary, CFTC, from Karrie McMillan, General Counsel, ICI, dated Feb. 13, 2012, *available at* https://www.ici.org/pdf/25910.pdf.

execution only if the swap is sufficiently liquid and the infrastructure supports adequately the trading of the swaps on a SEF or DCM. In addition, no swap should become MAT until the SEF(s) or DCM(s) listing that swap are operationally ready to support the execution requirement.