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February 10, 2014

Melissa D. Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Aggregation of Positions (RIN 3038-AD82)

Dear Ms. Jurgens:

The Investment Company Institute ("ICI")[1] is submitting this letter in response to the proposal by the Commodity Futures Trading Commission ("CFTC" or "Commission") to modify the aggregation provisions of Part 150 of the Commission's regulations.[2] The Aggregation Proposal would apply to futures and options contracts on nine agricultural commodities covered by the current Part 150 regulations and to futures, options, and swaps on the twenty-eight exempt and agricultural commodities covered by the CFTC's proposed amendments to Part 150, upon the effectiveness of the final rules.[3]

As investors in the futures and swaps markets, investment companies that are registered under the Investment Company Act of 1940 ("ICA") support the important objectives of preventing market

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[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 $16.5 trillion and serve over 90 million shareholders.

[2] Aggregation of Positions, 78 FR 68946 (Nov. 15, 2013), *available at* http://www.gpo.gov/fdsys/pkg/FR-2013-11-15/pdf/2013-27339.pdf ("Aggregation Proposal"). The CFTC previously adopted modifications to the aggregation provisions in part 151, which are substantially similar to the Aggregation Proposal. Those modifications were vacated by the Federal District Court for the District of Columbia in September 2012. The Court also vacated the CFTC's speculative position limits for the 28 exempt and agricultural commodity futures and options contracts and the physical commodity swaps that are economically equivalent to such contracts. The CFTC in a separate release has re-proposed those limits with some modifications. Position Limits for Derivatives, 78 FR 75680 (Dec. 12, 2013), *available at* http://www.gpo.gov/fdsys/pkg/FR-2013-12-12/pdf/2013-27200.pdf ("Position Limits Proposal").

[3] Position Limits Proposal, *id*.

manipulation and price shocks in commodity markets. Investment companies registered under the ICA ("registered funds") use swaps and other derivatives in a variety of ways to manage their portfolios in accordance with the investment objectives stated in their prospectuses. Derivatives are a particularly useful portfolio management tool in that they offer registered funds considerable flexibility in structuring their investment portfolios. Uses of swaps and other derivatives include, for example, hedging risks arising from portfolio investments, equitizing cash that a registered fund cannot immediately invest in direct equity holdings, managing a registered fund's cash positions, and adjusting the duration of a registered fund's portfolio.

The Aggregation Proposal is generally similar to the CFTC's existing aggregation rules in Part 150, with some modifications reflecting comments made in response to the CFTC's aggregation proposal issued in May 2012.[4] We strongly believe, however, that the proper application of the aggregation provisions, including the proposed Independent Account Controller ("IAC") exemption from the aggregation requirement, is critical to ensuring a reasonable imposition of position limits on registered funds and their asset managers. We, therefore, seek certain changes to, and clarifications of, the aggregation provisions to make them more workable for registered funds and other market participants.

Specifically, for the reasons discussed below, we believe that an investment adviser to registered funds should not be required to aggregate the positions of such funds for purposes of the position limits rule, provided that the funds have different investment strategies. We also request modification of the proposed IAC exemption to reflect the increased diversity in the types of market participants that may act as IACs. Finally, we recommend that the Commission not adopt the proposed requirement to aggregate positions in accounts or pools with "substantially identical trading strategies" to ensure that the exemptions from aggregation remain available to registered funds. These modifications are necessary to avoid potentially harmful repercussions to registered funds and their investors, particularly given the vast expansion of the scope of CFTC position limits under the Position Limits Proposal both in the range of commodities and the types of instruments subject to such limits.

<u>Positions of Registered Funds Managed by an Investment Adviser Should Not Be Aggregated</u>

Under the Aggregation Proposal, an investment adviser to more than one registered fund would be required to aggregate the positions of those registered funds for purposes of position limits unless it can avail itself of the IAC exemption (available generally only for subadviser relationships).[5] In effect, this proposed requirement would treat the futures and swap positions of diverse and separate

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[4] Aggregation, Position Limits for Futures and Swaps, 77 FR 31767 (May 30, 2012), *available at* http://www.gpo.gov/fdsys/pkg/FR-2012-05-30/pdf/2012-12526.pdf.

[5] To use the IAC exemption, the adviser generally would have to employ eligible subadvisers and implement an investment structure that would satisfy the IAC exemption.

funds, each with its own individual investment policies, objectives, and strategies, as fungible and subject to the unfettered control of the investment adviser. This treatment of registered fund positions, however, does not reflect the constraints imposed upon investment advisers by the requirements of the ICA and the Investment Advisers Act of 1940, under which the adviser is bound to act pursuant to the individual mandates and in the best interests of each fund.[6] Each registered fund must have clearly defined investment objectives, strategies, and policies, which are specified in public filings, available to investors, and filed with the U.S. Securities and Exchange Commission. Requiring aggregation of positions across all registered funds managed by a single adviser fails to recognize the individual investment objectives of each fund and the distinct uses of commodity interests in implementing the investment strategy of that fund. The proposed aggregation requirement would force the adviser potentially to forego beneficial uses of futures or swaps for a given fund or to liquidate futures or swaps positions to comply with the position limits. Therefore, aggregation should not be required for an investment adviser to registered funds, provided that those funds have different investment strategies.

We believe that the concerns that the aggregation requirements are meant to address – that "a single trader, through common ownership or control of multiple accounts, may establish positions in excess of the position limits and thereby increase the risk of market manipulation or disruption"[7] – are not present for registered funds. Each registered fund is a separate pool of securities with its own assets, liabilities, and shareholders. The registered fund's investment adviser is legally obligated to manage the fund's assets in accordance with that fund's investment strategy, policies, and limitations and must do so without taking into account the positions of other funds or client accounts that it manages.[8] Some registered funds may use commodity derivatives purely to hedge exposure to equity positions in companies that engage in commodity activities, while others may take positions to gain investment exposure with low correlations to other of their investments. Each registered fund has a board of directors that oversees the performance of the fund's service providers, including the investment adviser, under their respective contracts and monitors potential conflicts of interest. The different investment strategies and uses of commodity interests by the various funds managed by an adviser are reflected in the portfolio data scrutinized by the board, which also are available to investors and the general public. For the fund's board of directors, its investors and the marketplace, a discrepancy

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[6] *See* Section 206 of the Investment Advisers Act and Sections 36(a) and 36(b) of the ICA. As a fiduciary, investment advisers must, among other things, act in the best interest of their clients and place the interests of their clients before their own. *Securities and Exchange Commission v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 84 S. Ct. 275 (1963) (holding that Section 206 of the Investment Advisers Act of 1940 imposes a fiduciary duty on investment advisers by operation of law).

[7] Position Limits for Futures and Swaps, 76 FR 71626, 71652 (Nov. 18, 2011).

[8] These strategies are fully disclosed in the prospectus of a registered fund. In Item 9 of Form N-1A (the registration form for open-end funds) and the prospectus provided to investors, a fund must describe its principal investment strategies, including the particular type or types of securities in which the fund principally invests or will invest. A strategy includes any policy, practice, or technique used by the fund to achieve its investment objectives.

between the permissible trading strategies of the fund and its actual investments will be transparent.[9] If an investment adviser were to deviate from a registered fund's investment strategy to amass positions or engage in disruptive trading behavior, the investment adviser would be in violation of its fiduciary and contractual obligations to the fund, and oversight by the board exists to constrain such a breach.

Moreover, the proposed aggregation standards would create significant, and we believe, unintended, impediments to the use of commodity interests by registered funds and their advisers. For most fund complexes, one investment adviser manages multiple, and potentially hundreds of, registered funds. Such structures are fundamental to creating important efficiencies and cost-savings for the funds and their shareholders. The proposed aggregation standards, however, ignore the critical economic benefits of such structures and threaten to impair these efficiencies. If an adviser is required to aggregate the positions of all of the funds that it manages, it may need to refrain from making use of swaps or futures transactions that would otherwise be desirable investments for one or more funds. The CFTC would be restricting advisers from investing in these instruments for their registered funds without regard to whether such investments would best achieve a fund's investment objectives, which could negatively affect the fund and its shareholders. Alternatively, an adviser theoretically could restructure its advisory business to implement an investment structure that would satisfy the IAC exemption. The IAC structure, however, may not be necessary or desirable for a particular fund and would impose costs on fund shareholders. Either "option" would adversely affect fund shareholders, and we submit that imposing these costs on shareholders is not necessary to achieve the purposes of the position limit rules.

By limiting the aggregation requirement to registered funds that have the same investment strategies, the Commission would target the types of coordinated trading activity that the position limit rules are designed to address. The trading activity of registered funds with different strategies presents a very different scenario from that of funds trading in concert. Requiring aggregation of registered fund positions only where there is a potential for disruptive trading activity of the type sought to be prohibited by position limits would avoid restricting beneficial trading activity, without compromising the core policies underlying the position limits.

Definition of Independent Account Controller Should Be Modified

Under the proposed IAC exemption, an eligible entity (as defined) need not aggregate its positions with the eligible entity's client positions or accounts carried by an authorized IAC (except for the spot month in physical-delivery commodity contracts). The eligible entity and the IAC must comply with conditions that are designed to ensure that the IAC trades independently of the eligible entity and of any other IAC, subject to minimum control by the eligible entity to comply with

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[9] In fact, third parties that specialize in fund investing (*e.g.,* Morningstar) identify funds that diverge from their objectives and strategies.

supervisory and fiduciary duties. If the IAC is affiliated with the eligible entity or another IAC, each of the affiliated entities must ensure compliance with additional conditions to ensure separateness of their trading activities.

The Commission has proposed only one substantive modification to the existing rule – to expand the IAC definition to allow the exemption to be applied to any person with a role equivalent to that of a general partner in a limited liability partnership or a managing member of a limited liability company in light of changes in the marketplace. We believe, however, that several additional issues should be addressed. Specifically, the exemption as currently drafted does not contemplate exempt commodity trading advisors ("CTAs"), registered commodity pool operators ("CPOs"), or exempt or excluded CPOs acting as IACs, none of which would qualify under the proposed definition of IAC. We see no policy reason for not including these entities within the IAC definition.

Under Proposed Rule 150.1, to qualify as an IAC, a person must be registered as a futures commission merchant ("FCM"), an introducing broker, a CTA or an associated person of a registrant.[10] We believe that the definition of IAC should be modified to prevent unnecessarily limiting the availability of the exemption for investment advisers that are registered as CPOs or that are exempt or excluded from registering as a CTA or CPO.

With respect to registered CPOs, we note that such entities are the only category of CFTC registrant not included as qualifying IACs under the proposed rule (as is the case under the existing rule). We see no basis for this exclusion and request that registered CPOs be added to the list of other CFTC registrants qualifying as IACs.

With respect to exempt CTAs and exempt or excluded CPOs, we believe that these entities should qualify as IACs on the same basis as the enumerated categories of registered commodity professionals. Exempt CTAs and exempt or excluded CPOs have already been specifically determined by Congress or the CFTC to be qualified to act in the capacity of CTAs or CPOs without registration. These determinations reflect that the policy objectives of registration are satisfied by the nature of the entity (*e.g.,* as registered investment advisers) or the *de minimis* level of its activities subject to the

[10] The CFTC proposes to define "independent account controller" to mean a person (1) who specifically is authorized by an eligible entity, independently to control trading decisions on behalf of, but without the day-to-day direction of, the eligible entity; (2) over whose trading the eligible entity maintains only such minimum control as is consistent with its fiduciary responsibilities for managed positions and accounts to fulfill its duty to supervise diligently the trading done on its behalf or as is consistent with such other legal rights or obligations that may be incumbent upon the eligible entity to fulfill; (3) who trades independently of the eligible entity and of any other IAC trading for the eligible entity; (4) who has no knowledge of trading decisions by any other IAC; and (5) who is (i) registered as an FCM, an introducing broker, a commodity trading advisor, or an associated person of any such registrant, or (ii) a general partner, managing member or manager of a commodity pool the operator of which is excluded from registration under Rule 4.5 or Rule 4.13. *See* Position Limits Proposal, *supra* note 2 (Proposed Rule 150.1).

Commodity Exchange Act (*e.g.,* CPOs exempt from registration under Rule 4.13(a)(3) or excluded under Rule 4.5). Because the CTA and CPO exemptions and exclusions have been carefully designed to ensure that exempt and excluded entities may engage in commodity interest activities without jeopardizing the public interest in those activities, we believe that a CTA or CPO whose activities do not require registration with the CFTC should not be precluded from acting as an IAC. Accordingly, we respectfully request that the definition of IAC be expanded to include exempt or excluded CTAs and CPOs.

<u>Proposed Requirement to Aggregate Accounts or Pools with "Substantially Identical Trading Strategies" Should Not Be Adopted</u>

Under Proposed Rule 150.4(a)(2), for purposes of applying position limits, a person cannot avail itself of an exemption from aggregation (including the IAC exemption) if that person holds or controls the trading of positions in more than one account or pool with "substantially identical trading strategies." The current Part 150 aggregation requirements do not contain this provision. The CFTC position limit rules previously adopted under Part 151, which were vacated, would have required aggregation of accounts or pools with "identical trading strategies." The CFTC explained this requirement as being designed "to prevent circumvention of the aggregation requirements by, for example, a trader seeking a large long-only position in a given commodity through specific positions in multiple pools."[11]

We recommend that the Commission not adopt this proposed requirement because aggregation under these circumstances is unnecessary to achieve the Commission's policy objectives with respect to position limits and would undermine the long-standing IAC exemption. The Commission provides no further explanation or rationale in the Aggregation Proposal for the requirement to aggregate accounts or funds with substantially identical trading strategies. In particular, the Commission fails to explain why such aggregation should be required in cases where long-standing exemptions from aggregation would otherwise be available. The conditions under which aggregation exemptions are available are precisely those under which it is unlikely that a person would – or could – engage in manipulative or disruptive trading behavior. For example, the IAC exemption includes conditions that adequately prevent coordination of trading, including written procedures to preclude the affiliated entities from having knowledge of, gaining access to or receiving data about, trades of the other and such procedures must include arrangements that would maintain the independence of their activities. With these conditions, it is difficult to imagine how the eligible entity could employ the arrangement to amass purposefully large positions in an effort to circumvent the aggregation requirement. Therefore, we do not believe there is any reason to impose a different, stricter standard for aggregation than the Commission has used for more than 30 years. If the Commission believes it is necessary to create a wholly new standard, which may make the IAC exemption unavailable to asset

[11] Position Limits for Derivatives, 76 FR 4752, 4762 (Jan. 26, 2011).

managers that have relied on the IAC exemption for decades, we believe the Commission should identify the factual and policy grounds compelling such a result and seek public comment on its analysis.

If the Commission does not accept our recommendation that it decline to adopt the proposed requirement to aggregate accounts or pools with "substantially identical trading strategies," we request clarification that strategies that do not necessarily dictate the same specific trades would not be considered "substantially identical." Registered funds may be managed according to similar investment strategies that are disclosed in their prospectuses but also be managed completely separately and independently by advisers that are either affiliated or unaffiliated. For example, an adviser may have two bond funds (one managed directly and the other subadvised by unaffiliated IAC). The one fund may use swaps to gain exposure to certain currencies, and the second fund may use swaps to manage the fund's exposure to changes in interest rates or adjust portfolio duration. We do not believe that advisers in these circumstances should be prohibited from relying on the IAC exemption and be required to aggregate the positions of these registered funds for purposes of the position limits rule.

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We appreciate the opportunity to provide comments on the Aggregation Proposal. We believe that the Commission should incorporate the recommendations discussed above into its final rules to make the aggregation requirements and the IAC exemption more workable for market participants (including registered funds and their investment advisers) and to achieve better the Commission's regulatory objectives. If you have any questions on our comment letter, please feel free to contact me at (202) 326-5815, Sarah Bessin at (202) 326-5835, or Jennifer Choi at (202) 326-5876.

Sincerely,

/s/

Karrie McMillan
General Counsel

cc: The Honorable Mark Wetjen
The Honorable Bart Chilton
The Honorable Scott D. O' Malia