

ICI VIEWPOINTS

APRIL 15, 2011

CFTC Proposal Would Subject Funds to Duplicative, Conflicting Regulatory Requirements

By Sarah Bessin and Rachel Graham

Funds use swaps and other derivatives in a variety of ways to manage their investment portfolios, and many of these uses are unrelated to speculation. This is why we have been particularly concerned by a [proposal](#) from the Commodity Futures Trading Commission (CFTC) to revise Rule 4.5, which provides an exclusion for funds and certain “otherwise regulated” entities from regulation as commodity pool operators (CPOs).

This proposal, as we made clear in a recent [comment](#) letter and in [testimony](#) before Congress, would significantly narrow the Rule 4.5 exclusion as applied only to funds. If adopted in its current form, the proposal would subject many funds—which are already subject to [comprehensive regulation](#) under all four of the major federal securities laws—to duplicative and fundamentally inconsistent regulatory requirements.

The CFTC maintains that it needs to “stop the practice of registered investment companies offering futures-only investment products” without CFTC oversight. Under its proposal, a fund would only be exempt from CFTC regulation if it satisfies certain trading and marketing restrictions with respect to its positions in commodity futures, commodity options, and swaps. But the sweeping language of the proposal would reach far beyond the handful of funds that could reasonably be described as “futures-only” products. Instead, the proposed restrictions could affect hundreds, if not thousands, of funds.

Which funds could be affected? Based on our reading of the proposal and discussions with our members, the restrictions could implicate even basic S&P 500 stock funds and tax-exempt bond funds. These are investment products for buy-and-hold investors and retirement savers, not for speculators in the futures and options markets.

Here are just a few of the key concerns raised in our letter and testimony:

- **The proposed amendments to Rule 4.5 are premature and insufficiently developed** For example, the CFTC proposes a key trading restriction that would relate to margin levels on derivatives positions. ICI and its members cannot even assess the full impact of this proposed restriction because regulators have not yet determined which swaps will be subject to central clearing, what the margin requirements will be for cleared and uncleared swaps, and whether foreign exchange forwards and foreign exchange swaps will be exempted from the definition of “swap.”
- **The CFTC has failed to demonstrate the need for imposing a second layer of regulation on funds.** Moreover, its cursory cost-benefit analysis is wholly inadequate to justify the costly and burdensome regulation contemplated by the proposed amendments.
- **Some funds would become subject to duplicative and conflicting regulation.** Even if the proposed amendments to Rule 4.5 are appropriately scaled back, there are likely to be some funds (and their investment advisers) that would become subject to CFTC regulation. It is essential that the CFTC work closely with the SEC to reconcile the duplicative and conflicting regulatory requirements to which these funds would become subject. For example, the SEC significantly limits the ability of a fund to include in its prospectus performance information about other funds or accounts managed by the fund’s adviser. The CFTC rules, by contrast, in some cases *require* disclosure of such information. Funds simply cannot comply with both sets of rules in such instances.

The CFTC should carefully consider all concerns raised by ICI and [other commenters](#). If it continues to believe that amendments to Rule 4.5 are necessary, it should re-propose those amendments for public comment.

Sarah Bessin is Deputy General Counsel, Markets, SMAs & CITs, of the Investment Company Institute.

Rachel Graham is Associate General Counsel & Corporate Secretary at ICI.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.