



December 19, 2014

Via Electronic Mail

Ms. Sauntia S. Warfield
Assistant Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Proposed Guidance with respect to § 4.13(a)(3)

Dear Ms. Warfield:

Managed Funds Association¹ (“MFA”) respectfully urges the Commodity Futures Trading Commission (the “Commission” or “CFTC”) to provide commodity pool operators (“CPOs”) that invest in one or more collective investment vehicles with a more simplified alternative methodology to calculate and comply with the limitations of § 4.13(a)(3) (or the “Rule”). MFA submits this request to facilitate compliance with the Commission’s amendments to the registration and compliance obligations of CPOs and commodity trading advisors (“CTAs”).² We respectfully request that the CFTC consider including in its new guidance for § 4.13(a)(3) the suggestions presented in this letter as they would assist sponsors of funds with indirect commodity interest exposure who wish to rely on § 4.13(a)(3).

I. Background

As a result of recent amendments to the Commodity Exchange Act and the CFTC rules,³ many investment funds and other collective investment vehicles will now be deemed to be “commodity pools” because of their swaps exposure. Many of our members manage or operate

¹ The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

² See Final Rules for Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, 77 Fed. Reg. 11284 (Feb. 24, 2012).

³ See Section 721 of The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376; see also *supra* n. 2.

pools that invest in one or more other collective investment vehicles, some or all of which may be commodity pools. These “fund-of-fund” (“FOF”) pool managers include managers/operators of pools that, in turn, invest in commodity pools, such as, securitization vehicles, certain exchange-traded funds (“ETFs”), real estate investment trusts (“REITs”), and other vehicles that were not traditionally commodity pools (“Non-traditional Pools”), as well as managers/operators of pools that invest in other privately-offered funds or commodity pools.⁴ These members seek to rely, on the rescinded Guidance on the Application of § 4.13(a)(3) in the funds of funds context contained in former Appendix A (“Appendix A”) to the Commission’s Part 4 Regulations. We respectfully request that the CFTC adopt some simplified and more practical alternative provisions to include in Appendix A in order to provide clarity for these FOF firms seeking to operate their funds in a compliant and efficient manner.

At the time many of these vehicles were created, and at the time our members’ funds invested in them, CFTC rules did not classify them as commodity pools, to the extent the CFTC has concluded that certain products are commodity pools. This new categorization makes the rule changes particularly problematic and potentially very disruptive to strategies employed by our members in managing their FOFs, because members largely cannot secure contractual arrangements with underlying funds, and generally cannot obtain daily, weekly or even monthly information on an underlying fund’s commodity interest exposure.

Our members seek to comply with § 4.13(a)(3), however, it is not always clear to us how a CPO should calculate an investment in a Non-traditional Pool for purposes of the Rule. We believe that a FOFs that has a *de minimis* level of indirect commodity interest exposure should be able to rely on § 4.13(a)(3). We are concerned that due to the burdensome and impracticable nature of Appendix A that many FOFs will be unable to rely on § 4.13(a)(3). We understand the Commission is revising Appendix A to Part 4. This letter seeks to assist the Commission in addressing the regulatory issues surrounding investments in both traditional and Non-traditional Pools and to facilitate regulatory compliance. We recommend the Commission adopt a more simplified alternative methodology for FOFs to comply with § 4.13(a)(3) and provide a few suggestions below.⁵

II. Proposed Guidance with respect to Rule 4.13(a)(3) (“Proposed Guidance”)

We respectfully ask the Commission to adopt an alternative methodology, that does not require a FOF to look-through the investments of its underlying funds, in order for a FOFs to comply with § 4.13(a)(3) as part of a revised Appendix A. If adopted, the Proposed Guidance would greatly assist a fund (“Investor Fund”) that invests in one or more collective investment vehicles (“Investee Fund”) in calculating its commodity interest exposure to comply with §

⁴ We note that there are also many pools that may engage in a hybrid of activities. *I.e.*, a pool that engages in direct trading, invests in Non-traditional Pools and invests in one or more privately-offered funds or commodity pools.

⁵ See letter from the Securities Industry and Financial Markets Association (“SIFMA”) and the ASF to David A. Stawick, Secretary, CFTC, dated November 15, 2012, requesting for relief to address “legacy” structured finance transactions; see also letter from SIFMA to Chairman Gensler, Commissioners Sommers, Chilton, O’Malia and Wetjen and Director Barnett, dated November 14, 2012, regarding the applicability of commodity pool regulation to insurance linked securities.

4.13(a)(3). We present section A and section B as two alternative methodologies for calculating compliance with § 4.13(a)(3). We have included Sections C, D and E as supplemental guidance.

A. Modified Look Through

We believe the Commission should adopt a percentage threshold for the Investor Fund below which it would be acceptable not to look through an underlying fund, even if the underlying fund also directly trades commodity interests. We suggest either of the following formulations:

- 1) If an Investor Fund CPO invests 25% or less of the Investor Fund's net asset value ("NAV") in unaffiliated vehicles that trade commodity interests, the amount so invested should be excluded from the direct trading portion of the fund. Put differently, that amount would be deemed to satisfy the *de minimus* conditions of 4.13(a)(3). Use of this scenario would be conditioned upon each underlying fund being a limited liability vehicle. Thus, the Investor Fund could not lose more than its investment (and any undistributed profits) in any underlying fund.

OR

- 2) If an Investor Fund CPO invests 40% or less of the Investor Fund's NAV in unaffiliated vehicles that trade commodity interests, provided that no more than 25% is invested in private funds, the amount so invested should be excluded from the direct trading portion of the fund. Under this scenario, an Investor Fund may invest up to 40% of its NAV in listed or publicly traded vehicles, such as ETFs or listed REITs. We believe that the otherwise regulated nature of vehicles that are either listed or publicly-offered, coupled with their limited liability structures, justifies this relief.

The portion of the fund that is traded directly would at all times be required to satisfy the 5% margin or 100% net notional test of § 4.13(a)(3). The denominator for the direct trading portion would be the amount not invested in underlying funds.

We believe this scenario provides ample investor protection, while also relieving the CPO from complicated and potentially unrealistic data collection. Our members are finding that it is very difficult, if not impossible, to obtain information on an Investee Fund's level of commodity interest exposure. Investee funds often are reluctant to provide such detailed data about their portfolios to Investor Funds for competitive and other reasons. For example, the Commission recently granted No-Action relief to issuers of mortgage REITs⁶ and certain securitization vehicles,⁷ providing that while the mortgage REIT or certain securitization vehicle was still deemed to be a commodity pool, that the issuer would be exempt from registration as a CPO. Investors in such products trying to comply with § 4.13(a)(3), however, still need to

⁶ CFTC No-Action Letter No. 12-44 (Dec. 7, 2012).

⁷ CFTC Interpretation and No-Action Letter No. 12-45 (Dec. 7, 2012).

calculate the Investee Fund's commodity interest exposure and will find it very difficult to obtain such information from the Investee Fund, especially as the Investee Fund does not have to make such calculations.

B. Investments with Registered CPOs

As an alternative to section A, we believe an Investor Fund CPO should be permitted to disregard investments in funds operated by registered CPOs, subject to certain conditions.

We believe amounts invested in underlying funds of registered CPOs should be allowed to be disregarded when determining compliance with 4.13(a)(3) provided that: (i) such investments represent less than 50% of the Investor Fund's NAV; (ii) the Investor Fund CPO provides its investors with a risk disclosure statement based on the one contained in Rule 4.24 (see Annex 1); and (iii) the Investor Fund CPO agrees to report performance results to investors at least quarterly. Thus, reliance on this scenario would be conditioned upon the CPO's representation that it will comply with these three requirements.

C. Reasonable Belief and Diligence

We believe an Investor Fund CPO should be permitted to form a reasonable belief that its Investor Fund's investments are within acceptable limits.

The Commission should permit an Investor Fund CPO to rely on 4.13(a)(3) if the CPO can demonstrate that (i) reasonable efforts were undertaken to obtain information to ensure compliance, and (ii) the CPO reasonably believes that the Investor Fund still falls within the limitations of § 4.13(a)(3) based upon the information available to the CPO. Under the Proposed Guidance, a CPO shall institute a system of reasonable due diligence to attempt to obtain information on its underlying funds that trade commodity interests.

D. Obtaining Information from Underlying Funds

We believe the Commission should permit an Investor Fund CPO in complying with § 4.13(a)(3) to obtain information quarterly from its underlying funds that trade in commodity investments, where an Investor Fund chooses to look-through its Investee Funds to aggregate commodity interest exposure.

To avoid disruption to its trading strategy, rather than having to ensure compliance with the 4.13(a)(3) limitations on a constant basis, an Investor Fund CPO should be permitted to confirm the level of commodity interest trading in its underlying funds on a quarterly basis. If the CPO learns that the *de minimis* levels have been breached, in order to come back into compliance, the CPO could withdraw from one or more of the underlying funds at the next available withdrawal date.

E. Private Equity Fund and Closed-end Credit Fund Investments

We believe investments in private equity (“PE”) (including funds of PE funds) and closed-end credit (“CEC”) funds should be disregarded from the *de minimus* calculation, subject to certain conditions. An Investor Fund CPO should not be required to look through investments in PE and CEC funds because such investments are inherently illiquid. PE and CEC funds generally do not permit withdrawals. Thus, a breach of the 4.13 limits as a result of the investment in the PE or CEC fund cannot be rectified. In order to avoid creating an unavoidable conflict, an Investor Fund CPO should be permitted to disregard investments in PE and CEC funds toward the § 4.13(a)(3) *de minimis* limit. Use of this scenario could be conditioned upon the Investor Fund investing in PE and CEC funds that represent that the PE or CEC fund’s use of commodity interests will be limited to (i) hedging and risk management positions, and (ii) a *de minimis* level of non-risk reducing positions.

* * * * *

We appreciate the CFTC’s consideration of our proposals to design a more simplified alternative methodology for complying with § 4.13(a)(3) for fund-of-fund sponsors with commodity interests exposure. If you have questions or comments, please do not hesitate to contact the undersigned or Jennifer Han, Associate General Counsel, at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director,
General Counsel

CC: The Honorable Gary Gensler, Chairman
The Honorable Jill E. Sommers, Commissioner
The Honorable Bart Chilton, Commissioner
The Honorable Scott D. O’Malia, Commissioner
The Honorable Mark P. Wetjen, Commissioner
Gary Barnett, Director, Division of Swap Dealer and Intermediary Oversight
Amanda Olear, Special Counsel, Division of Swap Dealer and Intermediary Oversight
Michael Ehrstein, Attorney-Advisor, Division of Swap Dealer and Intermediary Oversight

Annex 1

CFTC RISK DISCLOSURE STATEMENT

YOU SHOULD CAREFULLY CONSIDER WHETHER YOUR FINANCIAL CONDITION PERMITS YOU TO PARTICIPATE IN A COMMODITY POOL. IN SO DOING, YOU SHOULD BE AWARE THAT COMMODITY INTEREST TRADING CAN QUICKLY LEAD TO LARGE LOSSES AS WELL AS GAINS. SUCH TRADING LOSSES CAN SHARPLY REDUCE THE NET ASSET VALUE OF THE POOL AND CONSEQUENTLY THE VALUE OF YOUR INTEREST IN THE POOL. IN ADDITION, RESTRICTIONS ON REDEMPTIONS MAY AFFECT YOUR ABILITY TO WITHDRAW YOUR PARTICIPATION IN THE POOL.

FURTHER, COMMODITY POOLS MAY BE SUBJECT TO SUBSTANTIAL CHARGES FOR MANAGEMENT, AND ADVISORY AND BROKERAGE FEES. IT MAY BE NECESSARY FOR THOSE POOLS THAT ARE SUBJECT TO THESE CHARGES TO MAKE SUBSTANTIAL TRADING PROFITS TO AVOID DEPLETION OR EXHAUSTION OF THEIR ASSETS. [THIS DISCLOSURE DOCUMENT CONTAINS A COMPLETE DESCRIPTION OF EACH EXPENSE TO BE CHARGED THIS POOL AT PAGE Error! Bookmark not defined. AND A STATEMENT OF THE PERCENTAGE RETURN NECESSARY TO BREAK EVEN, THAT IS, TO RECOVER THE AMOUNT OF YOUR INITIAL INVESTMENT, AT PAGES]

THIS BRIEF STATEMENT CANNOT DISCLOSE ALL THE RISKS AND OTHER FACTORS NECESSARY TO EVALUATE YOUR PARTICIPATION IN THIS COMMODITY POOL. [THEREFORE, BEFORE YOU DECIDE TO PARTICIPATE IN THIS COMMODITY POOL, YOU SHOULD CAREFULLY STUDY THIS DISCLOSURE DOCUMENT, INCLUDING A DESCRIPTION OF THE PRINCIPAL RISK FACTORS OF THIS INVESTMENT, AT PAGE]

YOU SHOULD ALSO BE AWARE THAT THIS COMMODITY POOL MAY TRADE FOREIGN FUTURES OR OPTIONS CONTRACTS. TRANSACTIONS ON MARKETS LOCATED OUTSIDE THE UNITED STATES, INCLUDING MARKETS FORMALLY LINKED TO A UNITED STATES MARKET, MAY BE SUBJECT TO REGULATIONS WHICH OFFER DIFFERENT OR DIMINISHED PROTECTION TO THE POOL AND ITS PARTICIPANTS. FURTHER, UNITED STATES REGULATORY AUTHORITIES MAY BE UNABLE TO COMPEL THE ENFORCEMENT OF THE RULES OF REGULATORY AUTHORITIES OR MARKETS IN NON-UNITED STATES JURISDICTIONS WHERE TRANSACTIONS FOR THE POOL MAY BE EFFECTED.

SWAPS TRANSACTIONS, LIKE OTHER FINANCIAL TRANSACTIONS, INVOLVE A VARIETY OF SIGNIFICANT RISKS. THE SPECIFIC RISKS PRESENTED BY A PARTICULAR SWAP TRANSACTION NECESSARILY DEPEND UPON THE TERMS OF THE TRANSACTION AND YOUR CIRCUMSTANCES. IN GENERAL, HOWEVER, ALL SWAPS TRANSACTIONS INVOLVE SOME COMBINATION OF MARKET

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RISK, CREDIT RISK, COUNTERPARTY CREDIT RISK, FUNDING RISK, LIQUIDITY RISK, AND OPERATIONAL RISK.

HIGHLY CUSTOMIZED SWAPS TRANSACTIONS IN PARTICULAR MAY INCREASE LIQUIDITY RISK, WHICH MAY RESULT IN A SUSPENSION OF REDEMPTIONS. HIGHLY LEVERAGED TRANSACTIONS MAY EXPERIENCE SUBSTANTIAL GAINS OR LOSSES IN VALUE AS A RESULT OF RELATIVELY SMALL CHANGES IN THE VALUE OR LEVEL OF AN UNDERLYING OR RELATED MARKET FACTOR.

IN EVALUATING THE RISKS AND CONTRACTUAL OBLIGATIONS ASSOCIATED WITH A PARTICULAR SWAP TRANSACTION, IT IS IMPORTANT TO CONSIDER THAT A SWAP TRANSACTION MAY BE MODIFIED OR TERMINATED ONLY BY MUTUAL CONSENT OF THE ORIGINAL PARTIES AND SUBJECT TO AGREEMENT ON INDIVIDUALLY NEGOTIATED TERMS. THEREFORE, IT MAY NOT BE POSSIBLE FOR THE COMMODITY POOL OPERATOR TO MODIFY, TERMINATE, OR OFFSET THE POOL'S OBLIGATIONS OR THE POOL'S EXPOSURE TO THE RISKS ASSOCIATED WITH A TRANSACTION PRIOR TO ITS SCHEDULED TERMINATION DATE.