MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

June 6, 2017

Via Electronic Submission

The Hon. J. Christopher Giancarlo
Acting Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Managed Funds Association Regulatory Priorities

Dear Acting Chairman Giancarlo:

Managed Funds Association[1] ("**MFA**") congratulates you on your nomination to become the new Chairman of the Commodity Futures Trading Commission (the "**CFTC**" or "**Commission**"). We very much appreciate the productive dialogue that we have had with you and other Commissioners in the past and look forward to continuing a constructive and cooperative relationship with the Commission under your leadership.

We wish to outline MFA's priority issues and related requests concerning the Commission's regulatory activity that affect the private fund industry. 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 markets. MFA has over 3,000 members from firms engaging in many alternative investment strategies all over the world. Many of our members are commodity pool operators ("**CPOs**") and/or commodity trading advisors ("**CTAs**") either registered with the Commission or exempt from registration.

MFA members favor smart, effective regulation of derivatives markets, and have a strong interest in thoughtful and efficient regulation of hedge fund managers. We applaud your Project KISS—Keep It Simple Stupid—initiative, and support the agency-wide review of CFTC

[1] 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, North and South America, and many other regions where MFA members are market participants.

regulations and practices to make them simpler, less burdensome, and less costly.[2] MFA supported many aspects of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**"), such as the Title VII requirement for centralized clearing of certain swaps.[3] Passage of the Dodd-Frank Act was followed by several years of intensive regulatory and rulemaking activity by the CFTC, in part to implement the statutory requirements of the Dodd-Frank Act. We agree that now that the CFTC has developed many of the key regulatory requirements of the Dodd-Frank Act, the Commission should review the results of its rulemakings and refine aspects of these rulemakings to enhance efficiency and reduce burden for the Commission and market participants. In addition, we greatly support and welcome under your leadership a resumption of "normalized operations and practices [by the CFTC, which] means a return to greater care and precision in rule drafting, more thorough econometric analysis, less contracted time frames for public comment and a reduced docket of new rules and regulations to be absorbed by market participants."[4]

In this letter, we raise several recommendations for regulatory improvements, which we believe will help the Commission achieve its regulatory objectives while making regulation simpler, more effective, and less burdensome. We would welcome the opportunity to meet with you, Commissioner Bowen, and Commission Staff in due course to discuss the issues outlined below in greater detail.

I. SUMMARY OF PRIORITY ISSUES

A. Rationalize CPO & CTA Regulation by Reducing Redundancy with the SEC

In the spirit of the President's "Core Principles for Regulating the United States Financial System,"[5] we believe the CFTC and the Securities and Exchange Commission ("**SEC**") should rationalize investment manager registration and systemic risk/compliance reporting requirements between the CFTC and the SEC. Doing so will simplify and streamline regulation of investment managers, making regulation more efficient and less costly and burdensome for registrants.

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

[3] Pub. L. 111-203, 124 Stat. 1376 (July 21, 2010), available at: http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/html/PLAW-111publ203.htm.

[4] *See supra* note 2.

[5] Presidential Executive Order on Core Principles for Regulating the United States Financial System, White House, February 3, 2017, available at: https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states.

1. Reduce Redundant Oversight and Reinstate § 4.13(a)(4) for Investment Management Firms Overseen by the SEC; Reduce Extraterritorial Scope; and Modernize and Update Regulation for those Entities that Should Remain Subject to CFTC Oversight

MFA requests that the Commission reinstate § 4.13(a)(4) for U.S. investment firms with advisers registered with the SEC or affiliated with an SEC-registered investment adviser. Such exemption will reduce duplicative registration and regulatory requirements; and make regulation more efficient, effective, and appropriately tailored for investment managers. MFA also encourages the Commission to work with the Alternative Investment Management Association ("AIMA") and other industry associations and foreign investment advisers to adopt a reasonable exemption for foreign investment advisers that would not be covered by any relief granted for SEC-registered investment advisers. Further, the Commission should modernize and update regulation for those entities that should remain subject to CFTC oversight.

2. Unify and Streamline Systemic Risk Reporting with the SEC

MFA requests that the CFTC and the SEC simplify and streamline systemic risk reporting by using a single, shorter systemic risk report administered by the SEC. Such a report would greatly enhance regulatory efficiency, and drastically simplify and reduce the burden and costs associated with systemic risk reporting. MFA also requests that the CFTC allow the National Futures Association ("**NFA**") to amend Form PQR to its pre-Dodd-Frank Act version and to make similar amendments to Form PR. These changes would further reduce regulatory costs and burdens for registered CPOs and CTAs while continuing to provide NFA with information it needs.

B. Foster Economic Growth and Vibrant Financial Markets by Abandoning the Proposed CFTC Position Limits Framework

MFA urges the CFTC to abandon its reproposed position limits rule (the "**Reproposal**").[6] We are strongly concerned that without having made a finding that excessive speculation exists in the markets or that position limits are necessary in each of the core referenced futures contracts, the Commission has failed to justify the economic need or basis for the Reproposal. Imposing unnecessary or inappropriate position limits will impair economic growth and place a greater burden on interstate commerce by hindering the ability of derivatives markets to: ensure that the price discovery function of the underlying market is not disrupted; and perform their fundamental risk transfer and risk management functions—both of which depend on the existence of liquid, fair and competitive markets to ensure sufficient market liquidity for *bona fide* hedgers.

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[6] Position limits for Derivatives, 81 Fed. Reg. 96,704 (proposed Dec. 30, 2016), available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-29483a.pdf.

C. Adopt Regulatory Refinements to Improve CFTC Swaps Trading Framework

MFA urges the CFTC to improve the legal framework for trading over-the-counter ("**OTC**") derivatives on registered swap execution facilities ("**SEFs**"). MFA believes the CFTC's work to promote swaps trading on SEFs has benefitted investors through increased pre-trade price transparency, competition, and liquidity. However, the implementation of the SEF framework can be refined and improved. MFA believes the CFTC should:

(1) Allow investors more flexibility in how they trade swaps while: (i) enabling true impartial access to SEFs and execution methods for all eligible participants, and (ii) preserving crucial requirements for pre-trade price transparency, price competition, and a multiple-to-multiple trading system or platform;

(2) Assume responsibility for determining when particular swap contracts have to be SEF traded while carefully considering the distinct liquidity issues for any such contract; and

(3) Simplify and codify the existing universe of CFTC staff guidance and no-action relief that the CFTC used to smooth the implementation of the SEF framework.

D. Enhance Data Security and Treatment of Confidential Information

MFA urges the Commission to continue using the subpoena process for requesting confidential, commercially valuable intellectual property, and to enhance its policies and procedures for protecting such information. MFA and its members are concerned about the high risk and threat of cyberespionage and data security at regulatory agencies. The Commission should adopt a policy to refrain from asking for highly confidential and commercially valuable intellectual property from a registrant or market participant unless absolutely necessary; and when it asks for such information, it should be through a Commission issued subpoena. The Commission should also have special procedures for protecting such information.

E. Simplify Regulation of Automated Trading

MFA urges the Commission to abandon Regulation AT, as proposed. We remain concerned that the underlying framework of Regulation AT is flawed. As an inefficient and ineffective regulation, Regulation AT will inhibit economic growth and impose inappropriate restraints on a large swath of market participants. We strongly believe that the Commission should fundamentally revise the underlying framework and, thus, abandon Regulation AT, including its supplemental proposal, as proposed. The Commission should simplify and modernize regulatory oversight of automated trading by adopting targeted regulatory solutions to address marketplace risk.

Division of Swap Dealer and Intermediary Oversight

F. Reduce Administrative Burden by Amending Part 4 Regulations Regarding Third-Party Recordkeeping

MFA commends the Commission for its adoption of final § 1.31, a modernized and significantly improved recordkeeping rule. MFA requests that the Commission allow CPOs and CTAs to engage in third-party recordkeeping arrangements without the need to make notice filings. Discrepancies between CFTC recordkeeping regulations for CPOs and CTAs and the SEC's recordkeeping arrangements for investment advisers make regulation burdensome and more expensive for dual registrants.

G. Exclude Compo Swaps From Calculation Under § 4.13(a)(3)

MFA requests that the Commission exclude "compo" equity total return swaps ("**compo swaps**") from calculation under § 4.13(a)(3) with respect to determining a pool's commodity interest position; and to issue related guidance. For regulatory simplification, we believe the Commission should allow a CPO to treat compo swaps as security-based swaps and exclude such products from its calculation of commodity interest positions for purposes of qualifying for an exemption from registration under § 4.13(a)(3), the *de minimis* trading exemption.

Division of Clearing and Risk

H. Advocate for Congress to Amend the Bankruptcy Code to Facilitate Full Physical Segregation of Customer Collateral

MFA requests that the Commission advocate for Congress to amend the Bankruptcy Code to facilitate full physical segregation of customer collateral. Ensuring the protection of customers and their collateral was one of Congress's goals under the Dodd-Frank Act; however, the current treatment of "customer property" under the Bankruptcy Code prevents customers and their assets from being fully protected from the failure of an FCM or another of the FCM's customers.

I. Encourage European Regulators to Resolve Equivalence Issues under EMIR Article 13 and MiFIR Article 33

MFA requests that the Commission engage with European authorities and encourage them to resolve equivalence issues under Article 13 of the European Market Infrastructure Regulation ("**EMIR**") and Article 33 of the Markets in Financial Instruments Regulation ("**MiFIR**"). As written, the language of Article 13 of EMIR and Article 33 of MiFIR prevent certain U.S. persons from satisfying their regulatory obligations under EMIR and MiFIR by complying with equivalent U.S. rules because those U.S. persons are not "established" in the U.S. This issue deeply affects the fund industry and the European banks with which they trade derivatives, and will hamper the ability of these market participants to continue to trade derivatives on a cross-border basis.

J. Protect the Assets and Interests of Customers in Regulations on CCP Recovery and Resolution

MFA believes that any regulations addressing the recovery or resolution of central counterparties ("**CCPs**") should protect the assets and interests of customers. As the Commission continues to consider whether it should issue regulations on this issue, we urge the Commission to ensure that it is protecting customers by allowing certain key principles to guide it. In particular, discussions of this issue have primarily taken place among regulators, CCPs, and FCMs, with customers being largely excluded, even though use of customer assets has been emphasized as a potential loss allocation tool. Because MFA's members manage the assets of their investor and taxpayer clients, any use of customer assets during a CCP's recovery or resolution results in losses to these investors and taxpayers, which is contrary to the core principles of the Dodd-Frank Act.

K. Recalibrate and Reduce Initial Margin Requirements to Better Reflect the Actual Risk of Certain Non-Clearable Swap Products

MFA believes that the Commission needs to recalibrate and appropriately tailor the initial margin ("**IM**") requirements for uncleared swaps to reflect the actual risk posed by certain non-clearable swap products, such as total return swaps ("**TRS**") for complex equity trades. Many hedge funds trade such TRS to achieve exposure to equities. However, as banks do not trade such TRS among themselves, our requested tailored revision to IM requirements for such products would present relatively little systemic risk. Therefore, funds that use non-clearable TRS should not be penalized by having to over-collateralize them based on the higher IM requirements that will be coming into effect for their uncleared trades on September 1, 2019 or 2020.

Division of Market Oversight

L. Reduce Complexity of Cleared Swap Reporting Requirements by Eliminating Alpha Swap Reporting

MFA believes the CFTC should eliminate alpha swap reporting requirements to reduce the reporting complexities of its cleared swaps reporting regime and to streamline the data actually reported without sacrificing the amount of information available to the CFTC regarding the entire life cycle of a swap. As you noted in a recent interview,[7] the Commission only needs the final information reported by the CCP concerning the beta/gamma swaps comprising a cleared swap for effective oversight.

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[7] "Giancarlo orders review of CFTC rules", *Risk.net*, March 15, 2017.

Bank Capital Regulations Affecting Customer Clearing

M. Recalibrate Leverage Ratio for Cleared Derivatives to Allow Offset for Segregated Client Initial Margin

MFA seeks the CFTC's help as a voting member of FSOC to achieve an important recalibration in the leverage ratio for cleared derivatives that will have a profound impact on customer clearing. As you noted in your recent public remarks, the CFTC has an influential role to play in achieving recalibrated bank regulatory capital requirements and leverage ratios to "better balance systemic risk concerns with healthy economic growth and American prosperity."[8] To ensure the continued affordability and robustness of customer clearing in the U.S., MFA suggests that bank regulators should recalibrate the leverage ratio rules to allow clearing members of CCPs to offset segregated IM when calculating exposure.

II. DISCUSSION OF ISSUES

In the spirit of refining and modernizing derivatives regulation to enhance efficiency and reduce regulatory burden, we have provided detailed discussions of our regulatory recommendations and the potential impact of these rule proposals. Please note that MFA has also previously submitted comment letters describing our recommendations in response to the CFTC's formal requests for comment. We would encourage you and the Staff to also refer to these letters, links to which are provided in the discussions.

A. Commodity Pool Operator & Commodity Trading Advisor Regulations

In the spirit of the President's "Core Principles for Regulating the United States Financial System,"[9] we believe that the CFTC and the SEC should rationalize investment manager regulation and systemic risk/compliance reporting requirements between the two agencies. Subjecting investment managers to two similar but slightly different regulatory frameworks have made regulation inefficient, ineffective, and extremely burdensome. SEC-registered investment management firms devote significant resources, including hundreds of thousands of hours, towards compliance with an additional regulatory regime. Similarly, we believe that such duplicative regulation is an unnecessary use of government resources. Thus, we propose that the Commission reinstate an exemption from CPO registration for investment firms registered with the SEC as investment advisers and unify and streamline systemic risk reporting with the SEC. In addition,

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[8] *See* Giancarlo Boca Speech, *supra* note 2. *See also* "Changing Swaps Trading Liquidity, Market Fragmentation and Regulatory Comity in Post-Reform Global Swaps Markets," Remarks of Acting Chairman J. Christopher Giancarlo before the International Swaps and Derivatives Association 32nd Annual Meeting in Lisbon, Portugal, May 10, 2017 (expressing concerns with the "misguided application" of the supplementary leverage ratio (SLR) to swaps clearing and proposing suggested SLR rule changes to reduce capital costs for clearing members).

[9] Presidential Executive Order on Core Principles for Regulating the United States Financial System, *supra* note 5.

we believe the Commission should reduce the extraterritorial scope of its CPO and CTA regulations, and modernize and update the Part 4 regulations, as discussed further below.

1. Reduce Redundant Oversight and Reinstate § 4.13(a)(4) for Investment Management Firms Overseen by the SEC; Reduce Extraterritorial Scope; and Modernize and Update Regulation for those Entities that Should Remain Subject to CFTC Oversight

MFA requests that the Commission reinstate CFTC § 4.13(a)(4), an exemption from registration for a CPO of a private commodity pool, for a CPO that is registered as an investment adviser with the SEC or affiliated with an SEC-registered investment adviser.[10] Such exemption will reduce duplicative registration and regulatory requirements with the SEC as well as the corresponding regulatory expenses and make regulation efficient, effective, and appropriately tailored for investment managers.[11] MFA also recognizes that the current CPO registration framework is overly broad in its extraterritorial reach and encourages the Commission to work with AIMA and other industry associations and foreign investment advisers to adopt a reasonable exemption for foreign investment advisers that would not be covered by any relief granted in response to our request for relief for SEC-registered investment advisers or their affiliated entities.

Reduce Redundant Oversight of Investment Managers

In 2012, not as a requirement, but in the "spirit" of the Dodd-Frank Act, the CFTC rescinded § 4.13(a)(4), which provided a person with an exemption from registration as a CPO if the interests in the pool were exempt from registration under the Securities Act of 1933 and the

[10] Many investment advisers have affiliated entities, which may be separately registered as investment advisers, CTAs, or CPOs, that provide services to investment funds managed by the registered adviser. For example, a private investment fund managed by a registered investment adviser may have a separate, affiliated entity that is the general partner and CPO of the fund. The SEC has recognized that an SEC-registered investment adviser may have affiliates that fall under the investment adviser definition and provides an exemption from registration under the Investment Advisers Act, provided certain conditions are met. *See generally ABA Subcommittee on Private Investment Entities*, SEC No-Action Letter (Dec. 8, 2005) and *American Bar Association Section of Business Law*, SEC No-Action Letter (Jan. 18, 2012). In these letters, the SEC staff has permitted special purpose entities ("SPVs") that act as general partners or managing members of private funds not to register under the Advisers Act if, among other conditions, the private funds are advised by a registered investment adviser and the SPVs are subject to the Advisers Act and the rules thereunder and subject to examination by the SEC. Similarly, the CFTC has allowed certain affiliated entities, to claim an exemption from CPO registration by delegating the CPO function to an affiliated registered CPO and meeting certain requirements. We believe the CFTC should include these types of entities affiliated with a registered investment adviser within the scope of the exemption.

[11] MFA has requested that the SEC adopt a rule or issue guidance that would subject firms to adviser registration with either the SEC or CFTC, depending on whether it is primarily engaged in the business of advising on trading in securities or futures, options, and/or swaps. *See* letter from Stuart J. Kaswell, Executive Vice President, Managing Director and General Counsel, MFA, to Jay Clayton, Chairman, SEC, dated May 18, 2017 on Regulatory Priorities, available at: https://www.managedfunds.org/wp-content/uploads/2017/05/MFA-Regulatory-Priorities-Letter-to-SEC-Chairman-Clayton.pdf.

operator reasonably believes that the participants are all qualified eligible persons.[12] MFA does not believe that the Commission documented a clear record of abuse that justified its rescission of the exemption, nor do we believe that the Commission can point to any tangible record of benefits that have resulted as a consequence of the repeal. In 2011, MFA submitted comments in response to the Commission's proposal to rescind § 4.13(a)(4) and argued, among other things, that: (1) rescission was unnecessary to achieve the public policy objectives of the Dodd-Frank Act; (2) § 4.13(a)(4) was consistent with and embedded in current law and inter-agency comity; (3) the Commission would still receive information it needed of private pools; and (4) rescission of § 4.13(a)(4) would be costly for managers.[13] We attach a copy of this letter as **Appendix A**. Unfortunately, rescission of § 4.13(a)(4) has increased dramatically the cost of operating an investment adviser. MFA believes that the CFTC should reinstate § 4.13(a)(4) for investment firms with advisers registered with and overseen by the SEC whether based inside or outside the United States—a narrower exemption than the original § 4.13(a)(4) exemption. Under our proposal, operators that are not registered with the SEC or affiliated with an SEC-registered investment adviser to the pool would still be required to register with the CFTC as a CPO.

The CFTC's rescission of § 4.13(a)(4) created a series of follow-on problems that imposed regulatory requirements on additional entities in circumstances that did not serve a clear public policy purpose. For example, the repeal required investment advisers (or affiliated entities) of privately offered investment funds that were registered with the SEC also to register with the CFTC unless they met the terms of one of the substantially narrower available exemptions.[14] The CFTC's final rule release regarding the rescission of § 4.13(a)(4) required investment advisers of fund-of-funds, including advisers that only invested in securities, to look through the holdings of their independent investments to determine whether they had a registration requirement.[15] As a result

[12] *See* Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, 77 Fed. Reg. 11252 (Feb. 24, 2012), available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2012-3390a.pdf. One could argue that the CFTC's action was not consistent with the "spirit" of the Dodd-Frank Act since sections 403 and 749 amended the Investment Advisers Act of 1940 and the Commodity Exchange Act to more clearly exempt from registration an entity registered with one agency and not engaged primarily in trading products overseen by the other agency. In other words, the Dodd-Frank Act itself sought to reduce redundant regulation, not add to it.

[13] *See* letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to David A. Stawick, Secretary, CFTC, dated Apr. 12, 2011, on Proposal to Rescind Sections 4.13(a)(3) and (a)(4), available at: http://www.managedfunds.org/wp-content/uploads/2011/06/4.12.11-MFA-CTA_CPO-Amendments-final.4.12.11.pdf. This letter is attached as Appendix A.

[14] *See* letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to David A. Stawick, Secretary, CFTC, dated Apr. 12, 2011, on Proposal to Rescind Sections 4.13(a)(3) and (a)(4), available at: http://www.managedfunds.org/wp-content/uploads/2011/06/4.12.11-MFA-CTA_CPO-Amendments-final.4.12.11.pdf. This letter is attached as Appendix A. *See also* CFTC § 3.10(c)(3)(i), Exemption from registration for certain persons.

[15] MFA has raised the concern that managers of fund-of-funds generally do not have position-level transparency of the funds in which they invest and to the extent they receive any such information it is on a delayed basis (*e.g.*, quarter-end), which makes it difficult for a CPO to calculate whether the fund indirectly trades more than a *de minimis* level of commodity interests, pursuant to CFTC § 4.13(a)(3). *See* letter from Karen L. Barr, General Counsel, Investment Adviser Association, and Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association, to Sauntia S. Warfield, Assistant Secretary, CFTC, dated November 9, 2012 on Request

of the rescission, many SEC-registered investment advisers (and/or affiliated entities) were required to be dually registered with both the SEC and CFTC, subject to two similar but different sets of regulatory requirements, and subject to multiple regulatory filings designed to achieve the same objectives (*i.e.*, Forms PF, CPO-PQR and CTA-PR). Further, the Commission's rescission of § 4.13(a)(4) greatly expanded the extraterritorial application of the CFTC's CPO and CTA regulations. Operators of a non-U.S. commodity pool with a single U.S. investor became subject to CPO regulation, as well as operators and/or advisors of non-U.S. commodity pools that engaged in even a single uncleared swap transaction with a U.S. counterparty.

Dual registrants have had to reconcile different regulatory requirements which has been extremely burdensome, especially as the CFTC has not had the resources to timely address regulatory interpretive issues. For example, we spent over two years urging the CFTC staff to provide relief with respect to the issue of CPO delegation,[16] and after the CFTC staff issued its initial No-Action relief,[17] following our request for further guidance and self-executing relief, the CFTC staff issued subsequent relief acknowledging that its prior letter posed too great a burden on the Division of Swap Dealer and Intermediary Oversight's limited resources.[18] While the CFTC staff has provided some relief, we continue to have concerns with how broadly it interprets the definition of CPO. Similarly, the CFTC has interpreted a broader number of related entities to a CPO registrant as "CPOs" or "commodity pools" for which a Form CPO-PQR needs to be filed, including pass-through vehicles that have no investors, creating additional filings and calculations which greatly increase compliance burdens but provide little additional regulatory value.

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for Delayed Compliance Date of Amended Part 4; Former Appendix A of the CFTC's Part 4 Regulations, available at: https://www.managedfunds.org/wp-content/uploads/2012/11/IAA-MFA-Comment-Letter-to-CFTC-re-Extension-of-Compliance-Date-of-Former-Appendix-A-11-9-12.pdf; *and* CFTC Staff Letter No. 12-38 (Nov. 29, 2012), available at: http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/12-38.pdf.

[16] The CFTC staff has held the view that a general partner, managing member or board of directors of a commodity pool, among others, may be considered a CPO and required to either register or delegate its rights and obligations as a CPO to a registered CPO. Initially, the CFTC staff took the position that each entity needed to seek individual no-action relief in order to delegate the CPO function, which we did not believe was a practical solution. Typically, large private investment companies have both domestic and offshore funds (*i.e.*, funds established outside the United States). Offshore funds are generally structured as corporate entities (rather than, for instance, as limited partnerships, as is common in the United States) and are governed by a board of directors. Such fund generally appoints a separate entity to serve as the fund's CPO (the "Designated CPO"). While the Designated CPO also may provide commodity interest trading advice and/or investment advice to the fund, often the Designated CPO appoints a separate entity (or entities) for this purpose. These arrangements can require multiple entities and individuals to either register as CPOs or seek No-Action relief to delegate the CPO function. *See* letter from Stuart J. Kaswell, EVP & Managing Director, General Counsel, MFA, to Mr. Gary Barnett, Director, Division of Swap Dealer and Intermediary Oversight, CFTC, July 15, 2014, available at: https://www.managedfunds.org/wp-content/uploads/2014/07/MFA-CPO-Delegation-Follow-up-to-Letter-14-69.final_.7.15.14.pdf.

[17] *See* CFTC Staff Letter No. 14-69, May 12, 2014, available at: http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/14-69.pdf.

[18] *See* CFTC Staff Letter No. 14-126, October 15, 2014, available at: http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/14-126.pdf.

Modernize and Update the Part 4 Regulations

In addition, MFA believes that the CFTC's Part 4 regulations have not kept pace with industry changes and other developments concerning CPOs and CTAs. For example, CPOs and CTAs have had concerns with the CFTC's limitations with respect to the use of third-party recordkeepers.[19] We are pleased to see that the CFTC has recently amended § 1.31.[20] However, differences between the CFTC's and the SEC's regulations contribute to increased regulatory costs for registrants with no additional value. Separately, we believe the Commission needs to modernize its Part 4 regulations to streamline regulation and make compliance more accessible for entities that remain registrants. Currently, it is extremely difficult for a CPO or CTA to ensure compliance with the CFTC Part 4 rules without retaining outside counsel with CPO/CTA expertise because a significant amount of rulemaking is found in CFTC staff letters from the past 10 or more years. These are only some of the examples of the concerns we have relating to CFTC part 4 regulations and/or guidance and would be pleased to separately discuss updating the CFTC's part 4 regulations to make regulation more efficient and less costly.

We believe that regulators have alternative tools to assist with effective industry oversight, and that CPO registration of SEC-registered investment advisers or their affiliates is not necessary to achieve the public policy objectives of promoting transparency and oversight of market participants. For example, the Dodd-Frank Act requires the SEC to share systemic risk information collected under Form PF with the CFTC, as a member of the Financial Stability Oversight Council ("**FSOC**").[21] Moreover, pursuant to legislative and regulatory requirements with respect to reporting and recordkeeping of cleared and uncleared swaps, the CFTC has access to detailed transaction-level information of commodity interest contracts.[22] Thus, the CFTC would continue to have necessary information on firms that would heretofore be registered as CPOs or CTAs, but that are registered with the SEC as investment advisers. To minimize duplicative registration and regulatory requirements of such firms, and to reduce the associated costs for regulators and market participants, the CFTC should provide an exemption from CPO registration for investment advisers registered with the SEC or affiliated with an SEC-registered investment adviser.[23]

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[19] Petition for Rulemaking to Amend CFTC §§ 1.31, 4.7(b) and (c), 4.23 and 4.33, Managed Funds Association, Investment Adviser Association, and Alternative Investment Management Association (July. 21, 2014), available at: https://www.managedfunds.org/wp-content/uploads/2014/07/Final-Petition.pdf.

[20] Final Recordkeeping Rule 1.31, 82 Fed. Reg. 24,479 (May 30, 2017), available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2017-11014a.pdf; *and* Proposed Amendments to § 1.31, 82 Fed. Reg. 6356 (Jan. 19, 2017). *See also* joint comment letter available at: https://www.managedfunds.org/wp-content/uploads/2017/03/MFA-AIMA-IAA-AMG-CFTC-Recordkeeping-Comment-Letter.final_.3.20.17.pdf.

[21] Section 404 of the Dodd-Frank Act.

[22] *See generally,* CFTC Parts 16 - 20, 45 and 49 Regulations.

[23] *See* discussion below on regulatory requirements.

Accordingly, MFA recommends that the CFTC reinstate § 4.13(a)(4) for investment firms with advisers registered with the SEC or affiliated with an SEC-registered investment adviser; and encourages the Commission to work with AIMA and other industry associations and foreign investment advisers to adopt a reasonable exemption for foreign investment advisers that would not be covered by any relief granted in response to our request for relief for SEC-registered investment advisers or their affiliates. MFA also recommends that the Commission modernize and update the CFTC Part 4 regulations.

2. Unify and Streamline Systemic Risk Reporting with the SEC

MFA requests that the CFTC and the SEC simplify and streamline systemic risk reporting by using a single, shorter systemic risk report administered by the SEC. Such a report would greatly enhance regulatory efficiency, and drastically simplify and reduce the burden and costs associated with systemic risk reporting. MFA also requests that the CFTC allow NFA to amend Form PQR to its pre-Dodd-Frank Act version. This change would further reduce regulatory costs and burdens for registered CPOs and CTAs while continuing to provide NFA with information it needs.

The Dodd-Frank Act requires the SEC and the CFTC, after consultation with FSOC, to jointly promulgate rules to establish private fund reports to be filed by dual registrants.[24] Instead, the SEC, CFTC, and NFA each require registrants to file slightly different systemic risk reports.[25] Investment firms that are registered as investment advisers, CPOs and CTAs are required to routinely file Forms PF, CPO-PQR, CTA-PR, PQR and PR.[26] The SEC and CFTC forms request for similar information, such as a schedule of investments. However, because the SEC and CFTC use different definitions, instruct registrants to use different methodologies to calculate responses, and the SEC allows registrants to file Form PF for a fund on an aggregated basis (*i.e.*, reporting master-feeder and trading subsidiaries on an aggregated basis) while the CFTC requires registrants to file Form CPO-PQR on a legal entity-by-entity basis, dual registrants file different systemic reports with the SEC and CFTC. Separately, while the SEC and CFTC take into consideration the size of a firm in determining the frequency of the filing, NFA requires all CPOs and CTAs to file quarterly reports.[27] Implementing separate processes for collecting and compiling data required

[24] Section 406 of the Dodd-Frank Act.

[25] The CFTC allows a CPO that is also registered with the SEC to satisfy a portion of its Form CPO-PQR filing requirements by filing Form PF with the SEC. However, such CPO still is required to file schedule A of Form CPO-PQR, which includes the burdensome and lengthy request for a schedule of investments. *See* Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, *supra* note 12 at 11,288 (providing reporting instructions).

[26] *See* Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, *supra* note 12; Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, 76 Fed. Reg. 71,128 (Nov. 16, 2011), available at: https://www.gpo.gov/fdsys/pkg/FR-2011-11-16/pdf/2011-28549.pdf; *and* NFA Rule 2-46, CPO and CTA Quarterly Reporting Requirements, available at: http://www.nfa.futures.org/nfamanual/NFAManual.aspx?RuleID=RULE%202-46&Section=4.

[27] *Id.*

by the different forms has been extremely burdensome and costly for registrants, causing registrants to expend thousands of hours each quarter to prepare the reports and respond to follow-up questions from regulators.

Similarly, each regulator also likely expends significant resources replicating analyses performed by other regulators. In addition, the SEC and CFTC forms do not lend themselves to being aggregated by FSOC. It is not clear that the differences in, or vast amounts of, data received by regulators have provided any measurable regulatory benefits, while the costs to registrants and regulators have been substantial. The SEC's Private Funds Statistics Reports indicate that private investment funds are not a source of systemic risk.[28] It is not clear to us whether the CFTC has had resources to dedicate to routinely analyze the reports from CPOs and CTAs. We understand that many of the data that the CFTC requested in Forms CPO-PQR and CTA-PR are not necessary for NFA; and that the pre-Dodd-Frank Act quarterly reports would be sufficient for NFA's regulatory purposes.

To simplify regulation, make it more efficient, conserve government resources, and reduce burden on regulators and registrants alike, the CFTC and the SEC should unify systemic risk reporting and adopt a single, shorter report administered by the SEC. MFA believes it would be more efficient for the same regulatory staff to both request and administer the systemic risk form, as registrants have found it inefficient for the CFTC and NFA staffs to share the responsibility. Further, we believe a single form would be more helpful to FSOC as it would allow FSOC to aggregate data from both regulators. Finally, a single, uniform systemic risk form would greatly reduce regulatory inconsistency, support good governance, and reduce cost and burden on registrants. NFA's pre-Dodd-Frank Act quarterly report was shorter and narrower in scope than the Forms CPO-PQR or PQR, and served NFA's purposes. We believe NFA should return to using its pre-Dodd-Frank Act quarterly report.

Accordingly, MFA recommends that the SEC and CFTC simplify and streamline systemic risk reporting by using a single, shorter systemic risk report administered by the SEC. MFA recommends that the CFTC allow NFA to amend Form PQR to its pre-Dodd-Frank Act version.

B. Foster Economic Growth and Vibrant Financial Markets by Abandoning the Proposed CFTC Position Limits Framework

The CFTC should not adopt the Reproposal. We are strongly concerned that without having made a finding that excessive speculation exists in the markets or that position limits are necessary in each of the core referenced futures contracts, the Commission has failed to justify the economic need or basis for the Reproposal. Imposing unnecessary or inappropriate position limits will impair economic growth and place a greater burden on interstate commerce by hindering the ability of derivatives markets to: ensure that the price discovery function of the underlying market is not disrupted; and perform their fundamental risk transfer and risk management functions—both of which depend on the existence of liquid, fair and competitive markets to ensure sufficient market

[28] *See* SEC Division of Investment Management Private Fund Statistics Reports, available at: https://www.sec.gov/divisions/investment/private-funds-statistics.shtml.

liquidity for *bona fide* hedgers. MFA does not support the Reproposal and urges the Commission to abandon it and reconsider what, if any, additional regulations are needed to meet its statutory objectives.

MFA welcomes a return to regular order and your remarks regarding "a return to greater care and precision in rule drafting" and "more thorough econometric analysis."[29] Regulatory policy, especially a policy as significant and with such a profound market impact as position limits, should be designed based on sound market and economic principles. MFA is concerned that the regulatory steps in the Reproposal are flawed and are potentially harmful to the health of the markets as they will reduce liquidity in U.S. derivatives markets. Aside from the overall imposition of position limits, the Reproposal will also deter use of the U.S. futures markets due to the regulatory and administrative complexity and costs associated with it.

Position limits are a crude and inefficient tool for deterring market manipulation because it is difficult to set limits at a level that inhibits market manipulation without unduly affecting the ability of markets to efficiently transfer risk. The Commission has better alternatives than to use such a blunt instrument for deterring market manipulation. Through the use of the current position reporting and market surveillance regime, and the ability to impose penalties for disruptive market behavior, the Commission and exchange surveillance staffs can detect and prevent corners, squeezes, and other forms of manipulation. It is preferable, therefore, to use readily available market data and the Commission's statutory authority to investigate and prosecute aggressive traders that manipulate or attempt to manipulate the market, rather than to limit the trading activity of all other market participants through position limits. An effective enforcement regime will discourage manipulation and assure a proper balance – preventing excessive speculation and deterring market manipulation, while ensuring sufficient market liquidity and price discovery.[30]

Accordingly, MFA urges the Commission to abandon the Reproposal. MFA remains interested in working with the Commission to address its concerns through regulations that are practical and based on sound market and economic principles. If the Commission determines to move forward with implementing position limits, we respectfully urge that the Commission narrowly tailor the regulatory framework to achieve a specific market outcome, in a way that is designed to be minimally disruptive, practical, and not overly complicated to administer by market participants. A concern that we raised with the Reproposal and the Commission's final aggregation rule[31] is that both these regulations are drafted in ways that unnecessarily create operational and interpretive challenges, making compliance complex, expensive and burdensome.

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[29] *See* Giancarlo Boca Speech, *supra* note 2.

[30] The CFTC has recognized that there is academic support for this notion, and has cited to a study by Craig Pirrong ("Squeezes, Corpses, and the Anti-Manipulation Provisions of the Commodity Exchange Act," Oct. 1, 1994). Position Limits for Derivatives, 78 Fed. Reg. at 75,695, available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2013-27200a.pdf.

[31] Aggregation of Positions, 81 Fed. Reg. 91,454 (Dec. 16, 2016), available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-29582a.pdf.

For specific comments on the Reproposal, we refer the Commission to MFA's letter in response to the Reproposal, linked below.[32]

C. Adopt Regulatory Refinements to Improve CFTC Swaps Trading Framework

MFA urges the CFTC to improve the legal framework for SEF trading. MFA believes the CFTC's work to promote swaps trading on SEFs has benefitted investors through increased pre-trade price transparency, competition, and liquidity. However, the implementation of the SEF framework can be refined and improved. MFA believes the CFTC should:

(1) Allow investors more flexibility in how they trade swaps while: (i) enabling true impartial access to SEFs and execution methods for all eligible participants, and (ii) preserving crucial requirements for pre-trade price transparency, price competition, and a multiple-to-multiple trading system or platform;

(2) Assume responsibility for determining when particular swap contracts have to be SEF traded while carefully considering the distinct liquidity issues for any such contract; and

(3) Simplify and codify the existing universe of CFTC staff guidance and no-action relief that the CFTC used to smooth the implementation of the SEF framework.

In October 2015, MFA submitted a petition to the CFTC to amend certain provisions of its regulations related to OTC derivatives trading on SEFs, based on MFA members' experiences to date and the "lessons learned" through the implementation process.[33] We outline below our updated positions and requests on key areas of regulatory reform for the CFTC's swaps trading framework raised in your White Paper,[34] as well as in your recent speeches earlier this year.[35]

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[32] *See* letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to Christopher Kirkpatrick, Secretary, CFTC, on Feb. 28, 2017, on Position Limits for Derivatives, available at: https://www.managedfunds.org/wp-content/uploads/2017/02/Final_Position-Limits-Comment-Letter-2017-MFA-AIMA-SIFMA-AMG.pdf.

[33] *See* MFA Petition for Rulemaking to Amend Certain CFTC Regulations in Parts 1 (General Regulations under the Commodity Exchange Act), 39 (Derivatives Clearing Organizations, Subpart B – Compliance with Core Principles) and 43 (Real-Time Public Reporting), submitted to Mr. Christopher Kirkpatrick, Secretary of the Commission, on October 22, 2015 ("**MFA SEF Petition**"), available at: https://www.managedfunds.org/wp-content/uploads/2015/10/CFTC-Petition-for-SEF-Rules-Amendments-MFA-Final-Letter-with-Appendix-A-Oct-22-2015.pdf.

[34] *See* "Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank", White Paper, by Commissioner J. Christopher Giancarlo, issued on January 29, 2015 ("**Giancarlo White Paper**"), available at: http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/sefwhitepaper012915.pdf.

[35] *See* Keynote Address of CFTC Commissioner J. Christopher Giancarlo Before SEFCON VII, "Making Market Reform Work for America", January 18, 2017, available at: http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-19; *see also* Giancarlo Boca Speech, *supra* note 2.

1. Methods of Execution

MFA supports a broader variety of execution methods so long as: (i) true impartial access to SEFs and execution methods are provided to all eligible participants, and (ii) requirements for pre-trade price transparency, price competition and a multiple-to-multiple trading system or platform are preserved.

The promotion of pre-trade price transparency on SEFs is an express goal of the Dodd-Frank Act.[36] MFA is concerned that the potential regulatory elimination of the order book and request-for-quote ("**RFQ**")-to-3 execution protocols, which are designed to provide pre-trade price transparency, could undermine the pre-trade price transparency statutory goal for SEFs.

MFA is also concerned that the potential elimination of the current required methods of execution (*i.e.*, the order book and RFQ-to-3 execution methods) would remove pre-trade transparency in the U.S. SEF trading regime, and thereby raise a point of difference with the EU's MiFID II regulations governing pre-trade transparency of OTC derivatives trading on multilateral trading facilities ("**MTFs**") and organised trading facilities ("**OTFs**"). MFA encourages the CFTC to consider carefully introducing additional points of difference with the EU derivatives trading regime to avoid undermining equivalence and comparability determinations.

2. MAT Determination Process

While expanding the methods of execution available on SEFs would be a welcome development, the CFTC's authorization of more flexible execution methods does not mean that all mandatorily cleared, non-MAT products will suddenly be suitable for SEF trading. In MFA's view, flexibility in execution alone is not enough to promote swaps trading on SEFs, as it would not address the sufficiency of a product's liquidity or the ability of all eligible market participants to access all SEFs that will offer broader methods of execution and diverse liquidity in trading the product.

MFA supports the CFTC assuming a more meaningful oversight role in the "made available to trade" ("**MAT**") determination process, including its ability to reject MAT determinations from SEFs. MFA strongly suggests that the CFTC keep the MAT determination process separate from the clearing determination, because clearing suitability does not assess adequately the liquidity features of the swap product in question. MFA believes the CFTC has an important role to play in carefully considering the distinct liquidity-related factors with respect to a clearing-mandated swap product before requiring it to trade on-SEF. MFA urges the CFTC not to adopt a simplistic construction of the trade execution requirement that would require any mandatorily cleared and listed swap product automatically to become subject to the trading mandate. MFA fears that such a construction would inextricably link the trading mandate to the clearing mandate and discourage the industry from bringing more products into central clearing.

[36] *See* section 733 of the Dodd-Frank Act, adding Commodity Exchange Act (CEA) section 5h(e); 7 U.S.C. 7b-3(e).

In that connection, MFA reiterates the MFA SEF Petition request to provide a mandatory comment period for every MAT determination submission by a SEF or a designated contract market ("**DCM**") under Part 40 of the Commission's regulations. MFA also reiterates the MFA SEF Petition request to establish a clear de-MAT determination process when a swap product no longer exhibits the requisite liquidity profile to trade on-SEF.

MFA agrees with many of your concerns with respect to package transactions.[37] MFA encourages the CFTC to consider the proposed amendments in the MFA SEF Petition as an alternative approach to resolve those concerns by requiring SEFs to make MAT determinations separately for a given swap when executed on a stand-alone basis and for different types of package transactions that include such a swap.

Taken together, MFA's proposed amendments in the MFA SEF Petition with respect to the MAT determination process would improve the CFTC's process and facilitate equivalence discussions with the EU by moving the CFTC's process a step closer in comparability to the European Securities and Markets Authority's ("**ESMA**") process for determining which mandatorily cleared OTC derivative products will become subject to the derivatives trading obligation under the MiFID II regime.

3. Impartial Access

MFA believes the buy-side should have fair, unbiased and unprejudiced access to SEFs that offer more execution modalities. More specifically, the buy-side needs true impartial access, without adverse commercial repercussions, to legacy interdealer broker ("**IDB**") SEF order books and voice-brokered IDB trading functionality in order to more efficiently trade package transactions and stand-alone swaps that are not MAT. Our position is based on the serious challenges MFA members continue to face trading such products using the RFQ system on dealer-to-customer SEFs, where they have lost the ability to place resting orders.

The CFTC should enforce true impartial access to all SEFs, in conjunction with authorizing more flexible execution methods on SEFs, by removing artificial barriers that hinder the achievement of the Dodd-Frank Act goals to promote swaps trading and pre-trade price transparency on SEFs. MFA believes that the current bifurcated swaps market structure has not, and will not, achieve these statutory goals if such barriers to true impartial access persist in the U.S. SEF regime. We highlight examples of such barriers below.

As MFA explained in its position paper,[38] the legacy practice of post-trade name disclosure or "name give-up" on IDB SEFs that offer anonymous execution of cleared swaps is a key

[37] *See* Giancarlo White Paper at p. 26 (stating that "many package transactions are ill-suited to Order Book or RFQ System execution given their limited liquidity and complex characteristics.")

[38] *See* MFA Position Paper: *Why Eliminating Post-Trade Name Disclosure Will Improve the Swaps Market*, dated March 31, 2015, available at: https://www.managedfunds.org/wp-content/uploads/2015/04/MFA-Position-Paper-on-Post-Trade-Name-Disclosure-Final.pdf.

mechanism that continues to prevent the buy-side from accessing important pools of liquidity for cleared swaps, including the only liquid order books. The practice's exclusionary effect on otherwise qualified buy-side market participants is status-based discrimination and thus inconsistent with the impartial access mandate for SEFs. MFA believes that the practice also reduces pre-trade price transparency for otherwise qualified buy-side market participants and restricts their ability to trade certain swap products anonymously. The effects of this practice are anti-competitive and have been challenged in recent federal antitrust lawsuits brought in the U.S. District Court, Southern District of New York. MFA believes that if the free market was going to address the effects of this anti-competitive practice organically, it would have done so by now. However, it is difficult for any one IDB SEF to disable post-trade name disclosure unilaterally, as traditional dealers that opposed such a change might easily shift their trading to other IDB SEFs. This is a classic case where the CFTC, as the primary regulator of the U.S. swaps market, can readily bring competition and fairness to the market.

With respect to the use of enablement mechanisms and breakage agreements for swaps that are intended to be cleared on SEFs, MFA reiterates the MFA SEF Petition request to prohibit such arrangements by codifying existing CFTC staff guidance around the implementation of the CFTC's impartial access requirements.

MFA members also remain concerned with the lack of transparency concerning SEF fee structures. As regulated entities, all SEFs should be required to publish their fee schedules. MFA understands that certain SEFs have pricing schemes and volume rebates that deter buy-side access, as pricing is only viable and affordable for certain firms to access such SEFs.

MFA also urges the CFTC to finalize dealer ownership restrictions or thresholds for SEF governance, as dealer-dominated SEFs create the risk of conflicts of interest.

Similar to the U.S. impartial access requirement, the European MiFID II legislation requires trading venues to provide non-discriminatory access to market participants.[39] As such, there should be no difference between the two regimes on this topic, though European regulators may be required to issue additional guidance (similar to the CFTC's impartial access guidance[40]) in order to ensure that the non-discriminatory access requirement is properly implemented. MFA believes that ensuring equivalent standards with respect to the implementation of impartial access should be a key focus in future discussions regarding harmonization and regulatory equivalence.

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[39] *See* Article 18(3) of the MiFID II Directive governing MTFs and OTFs, and Article 53(1) of the MiFID II Directive governing regulated markets.

[40] *See* "Division of Clearing and Risk, Division of Market Oversight and Division of Swap Dealer and Intermediary Oversight Guidance on Application of Certain Commission Regulations to Swap Execution Facilities", issued Nov. 14, 2013, available at: http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/dmostaffguidance111413.pdf.

4. STP and Void *Ab Initio*

MFA reiterates the MFA SEF Petition request to codify existing CFTC staff guidance around the CFTC's straight-through processing ("**STP**") requirements. MFA believes that STP is critical to a competitive, open and transparent market for swaps that are intended to be cleared.

STP benefits all market participants, especially smaller market participants and alternative liquidity providers that could otherwise encounter barriers to entry, in that it: (i) gives market participants certainty of clearing immediately following execution, which in turn, allows them to hedge more efficiently and effectively manage risk; (ii) is an important factor in encouraging the implementation of broad, mandatory clearing; (iii) is essential to electronic trading, particularly central limit order book trading, as it is not possible to enter into an electronic transaction on an anonymous basis without both the immediate confirmation of the execution of the transaction and its acceptance for clearing; and (iv) promotes accessible, competitive markets and access to best execution by ensuring parties to a cleared transaction have immediate confirmation that they will face the relevant CCP, thus eliminating the need to negotiate individual credit arrangements with each of their counterparties, as is required in bilateral derivatives markets.

MFA views void *ab initio* as an important part of the STP regime that should be preserved. More specifically, MFA reiterates the MFA SEF Petition Request to codify, with clarifying modifications, existing CFTC staff guidance and extended no-action relief under CFTC No-Action Letter 17-27 around rejection of swaps from clearing and resubmission for operational and clerical errors.[41]

MFA notes that ESMA included both void *ab initio* and a resubmission procedure in its regulatory technical standards under the EU's MiFID II/MiFIR. As a result, codifying these points would further facilitate harmonization between SEFs/DCMs and MiFID II trading venues.

5. The "Occurs Away" Requirement for Block Trades

MFA believes the "occurs away" requirement is unnecessarily complex, and agrees with your views on this issue. Accordingly, MFA reiterates the MFA SEF Petition request to modify the definition of "block trade" in Part 43 of the Commission's regulations to authorize on-SEF execution of a block trade as a Permitted Transaction, as defined in section 37.9(c), in order to facilitate pre-execution credit checks of block trades that are intended to be cleared.

6. Footnote 88 SEF Registration Mandate for FX PB Platforms

MFA requests CFTC guidance to clarify ambiguities surrounding SEF trade execution of FX prime brokerage transactions, in particular non-deliverable forward contracts, on multiple-to-multiple platforms that had to register as SEFs. These registered SEFs do not list any clearing-

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[41] *See* CFTC Staff Letter No. 17-27, May 30, 2017, available at: http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/17-27.pdf.

mandated Required Transactions. The application of SEF requirements for cleared trades executed on these platforms is a point of ambiguity that continues to impede trading on these platforms.

7. Uncleared Swaps Confirmations

MFA requests that the CFTC adopt a modified confirmation delivery requirement in section 37.6(b) for uncleared swaps that will respect confidentiality concerns of the counterparties. MFA appreciates the current no-action relief that will expire on the effective date of any changes in the regulation.[42] Without such relief, buy-side market participants would be required to disclose the terms of all of their ISDA Master Agreements to SEFs, which raises material concerns regarding confidentiality and practicality. MFA strongly agrees with your criticisms of the confirmation requirement as expressed in the Giancarlo White Paper. Accordingly, we support a rule amendment to section 37.6(b) that would make the confirmation delivery requirement workable for SEF market participants.

D. Enhance Data Security and Treatment of Confidential Information

MFA urges the Commission to continue using the subpoena process for requesting for confidential, commercially valuable intellectual property, and to enhance its policies and procedures for protecting such information. MFA and its members are concerned with the high risk and threat of cyberespionage and data security at regulatory agencies. Information security vulnerabilities at a regulator will jeopardize not only market participants and their investors, but the U.S. economy through the loss of domestic trade secrets and confidence in the integrity of the regulatory framework. Over the last several years, due to both statutory mandates and regulatory discretion, the Commission has expanded the scope and breadth of the types of information that it requests of registrants. It has, however, generally continued to rely on the same framework for information collection and protection. MFA believes that the Commission needs to reexamine and rethink its policies and processes for collecting and protecting non-public and confidential information. We are aware of statutory provisions designed to protect the confidential and proprietary information of registrants, but without robust, updated policies and procedures at the CFTC, we are concerned that the Commission is unable to adequately protect such information.[43]

MFA was highly alarmed with the Commission's 2015 proposal through Regulation AT to allow regulators to inspect a registrant's algorithmic trading source code. We are concerned that regulators, at times, unnecessarily request highly confidential and commercially valuable information, without exhausting other less sensitive means of understanding a firm's activities,

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[42] *See* CFTC Staff No-Action Letter No. 17-17, "Extension of No-Action Relief for Swap Execution Facility Confirmation and Recordkeeping Requirements under Commodity Futures Trading Commission Regulations 37.6(b), 37.1000, 37.1001, 45.2, and 45.3(a)", issued on March 24, 2017, available at: http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/17-17.pdf.

[43] *See, e.g.,* Section 8 of the Commodity Exchange Act; *and* Federal Information Security Modernization Act of 2014, 44 U.S.C. § 3551 (2014). *See also* 18 U.S.C. § 654 (1996) (prohibiting an officer or employee of United States converting property of another); *and* 18 U.S.C. § 1905 (2008) (prohibiting public officers and employees of disclosure of confidential information generally).

and then do not have robust procedures for protecting such information. We support regulators having the information they need to oversee registrants and to surveil markets; however, this authority needs to be balanced with the potential risk of irrevocable harm (*e.g.*, unauthorized disclosure or misappropriation of trade secrets) to registrants and their due process rights.[44] To be clear, MFA has never disputed the Commission's authority to obtain confidential materials that it needs to enforce the law. However, the CFTC should adopt a general policy to refrain from asking for highly confidential and commercially valuable intellectual property from a registrant or market participant unless absolutely necessary; and when it asks for such information, it should be through a Commission issued subpoena. We believe that the Commission itself, and not the staff, should have to make the necessary determination that the CFTC needs access to such sensitive materials to discharge properly the Commission's regulatory responsibilities. We strongly agree and support your view that the subpoena process provides a fair compromise between the rights of property owners and the government's right to seize their property.[45]

In addition, we think the CFTC needs to have an information security policy in which the protections and security requirements are heightened or tiered depending upon the level of sensitivity of the data collected, including how to dispose of or return the data, if no wrongdoing is found, at the end of the examination, investigation or query. The Dodd-Frank Act imposed heightened confidentiality protections with respect to systemic risk information that the SEC collects from managers of private funds.[46] Similarly, we think the CFTC should impose heightened procedures and standards with respect to Forms CPO-PQR and CTA-PR and other highly sensitive and confidential information that it receives. The Commission should also consider industry practices and standards with respect to protecting confidential intellectual property. Market participants go to great lengths to protect sensitive intellectual property, implementing practices shaped by case law from intellectual property cases. We think it is only appropriate for the Commission to apply consistent protections.

Accordingly, MFA respectfully urges the Commission to continue using the subpoena process for requesting for confidential, commercially valuable intellectual property, and to enhance its policies and procedures for protecting such information. Specifically, the Commission should adopt a policy to refrain from asking for highly confidential and commercially valuable intellectual property from a registrant or market participant unless absolutely necessary; and when it asks for such information, it should be through a Commission issued subpoena. The Commission should also have special procedures for protecting such information. MFA would be pleased to discuss with the Commission common industry practices for protecting confidential intellectual property.

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[44] *See* Statement of Dissent by Commissioner J. Christopher Giancarlo Regarding Supplemental Notice of Proposed Rulemaking on Regulation Automated Trading, November 4, 2016, (expressing that allowing the CFTC to inspect algorithmic source code "would strip owners of intellectual property of due process of law" and that the "subpoena process provides property owners with due process of law before the government can seize their property.") available at: http://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement110416.

[45] *Id.*

[46] *See* section 404 of the Dodd-Frank Act.

E. Simplify Regulation of Automated Trading

MFA urges the Commission to abandon its notice of proposed rulemaking on the regulation of automated trading[47] ("**NPRM**") and its supplemental notice of proposed rulemaking on Regulation AT[48] ("**Supplemental Proposal**") (together with the NPRM, "**Regulation AT**"), as proposed. While we believe that the CFTC Staff has attempted to incorporate comments it received on the NPRM into the Supplemental Proposal, we remain concerned that the underlying framework of Regulation AT is flawed. Regulation AT will inhibit economic growth, create inefficient and ineffective regulation, and impose inappropriately tailored regulation on a large swath of market participants. We strongly believe that a fundamental revision is necessary. The Commission should simplify and modernize regulatory oversight of automated trading by adopting targeted regulatory solutions to address marketplace risk.

Contrary to the Commission's intention, we believe that, as drafted, Regulation AT would create new risks, impose inefficient and ineffective requirements and burdens on the CFTC, DCMs, and market participants. In our view, Regulation AT proposes to apply a very prescriptive, unnecessary, one-size-fits-all regulatory framework on many different types of market participants. For example, the definitions under Regulation AT continue to be so broad that almost all trading by market participants will fall under the definitions of Algorithmic Trading and Direct Electronic Access. Subjecting market participants to Regulation AT for the use of third-party Algorithmic Trading systems places them in the untenable position of being responsible for systems and processes for which they have no technical expertise and to which they have no access. We are also concerned that in prescribing rigid controls and standards, Regulation AT does not provide enough flexibility for the markets and market participants to innovate or adjust controls or processes, as they deem appropriate or necessary, to address new technologies and circumstances in the future.

We believe the Commission should modernize regulatory oversight of automated trading by adopting targeted regulatory solutions to address marketplace risk. In doing so, we support the Commission developing a regulatory framework that establishes baseline risk controls among "gatekeepers" such as DCMs and executing futures commission merchants ("**FCMs**") or clearing firms to address the risk of market disruption. We believe that the Commission should add any regulations by integrating them into the existing regulatory framework. Attempting to "modernize" oversight by simply layering another level of regulation on market participants and subjecting them to multiple DCM oversight creates an unwieldy and inefficient regulatory regime.

To the extent that the Commission believes it needs more information from CTAs or CPOs, or that these registered entities need enhanced controls, we would strongly urge the Commission to direct the NFA to amend its Annual Questionnaire. From the data NFA collects through its

[47] *See* Proposed Regulation Automated Trading, 80 Fed. Reg. 78,824 (Dec. 17, 2015), available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2015-30533a.pdf.

[48] *See* Supplemental Notice of Proposed Rulemaking: Regulation Automated Trading, 81 Fed. Reg. 85,334 (Nov. 25, 2016), available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-27250c.pdf.

Annual Questionnaire, the Commission would be able to assess whether additional requirements are necessary to address risk concerns. We think that such a targeted approach would more precisely achieve the Commission's goals at lower cost.[49]

Finally, we strongly concur that the Commission has adequate authority through the subpoena process to seek Algorithmic Trading Source Code and that the Commission should continue relying on this authority rather than circumvent an intellectual property owner's right to due process of law.[50]

Accordingly, we recommend that the Commission abandon Regulation AT, as proposed, and instead to: (1) reduce electronic trading risk by implementing a risk control framework at the marketplace gatekeeper levels—DCMs and executing FCMs or clearing firms; and (2) build on the existing regulatory framework, as necessary, to oversee registrants, such as CTAs and CPOs.[51]

DIVISION OF SWAP DEALER AND INTERMEDIARY OVERSIGHT

F. Reduce Administrative Burden by Amending Part 4 Regulations Regarding Third-Party Recordkeeping

MFA commends the Commission for its adoption of final § 1.31, a modernized and significantly improved recordkeeping rule.[52] MFA requests that the Commission amend the CFTC Part 4 regulations to allow CPOs and CTAs to engage in third-party recordkeeping arrangements without the need to make notice filings. Discrepancies between CFTC recordkeeping regulations

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[49] *See* letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to Christopher Kirkpatrick, Secretary, CFTC, on Mar. 16, 2016, on Proposed Regulation Automated Trading, available at: https://www.managedfunds.org/wp-content/uploads/2016/03/MFA-RegAT-Letter-final.pdf.

[50] *See* Statement of Dissent by Commissioner J. Christopher Giancarlo Regarding Supplemental Notice of Proposed Rulemaking on Regulation Automated Trading, November 4, 2016 (hereinafter "Giancarlo Statement of Dissent"), available at: http://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement110416.

[51] *See* letter from Stuart J. Kaswell, Executive Vice President, Managing Director and General Counsel, MFA, to Christopher Kirkpatrick, Secretary, CFTC, dated May 1, 2017 on the Supplemental Proposal on Regulation AT, available at: https://www.managedfunds.org/wp-content/uploads/2017/05/MFA.AIMA_.Reg-AT.Supp_.pdf.

[52] Final Recordkeeping Rule 1.31, 82 Fed. Reg. 24,479 (May 30, 2017), available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2017-11014a.pdf. *See* Recordkeeping Proposal, 82 Fed. Reg. 6,356 (Jan. 19, 2017), available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2017-01148a.pdf; *and* letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, Karen Barr, President and Chief Executive Officer, Investment Adviser Association, Jiří Król, Deputy CEO, Global Head of Government Affairs, Alternative Investment Management Association, and Laura Martin, Managing Director and Associate General Counsel, SIFMA Asset Management Group, to Christopher Kirkpatrick, Secretary, CFTC, on Mar. 20, 2017, on Recordkeeping (hereinafter "**Comments on Proposed Recordkeeping**", available at: https://www.managedfunds.org/wp-content/uploads/2017/03/MFA-AIMA-IAA-AMG-CFTC-Recordkeeping-Comment-Letter.final_.3.20.17.pdf.

for CPOs and CTAs and the SEC's recordkeeping arrangements for investment advisers make regulation burdensome and more expensive for dual registrants.

In 2014, MFA, jointly with other associations, submitted a petition to the Commission to modernize CFTC recordkeeping § 1.31 and other regulations ("**Recordkeeping Petition**"), as we were concerned that the regulations' incorporation of outdated technology and incongruity with standard market practices exposed registrants to security risks and increased compliance costs.[53] We are pleased that the Commission has amended § 1.31 in a technology neutral manner, and appreciate that the rule text is straight-forward and easy to understand. As we raised in our Recordkeeping Petition and in our comments on the Commission's proposed amendments to § 1.31, we continue to urge the Commission to amend the CFTC Part 4 regulations to permit records entities to maintain records at locations other than their main business office and to engage third parties, use certain facilities or cloud-based applications, or enter into any other desired recordkeeping arrangements with third parties.[54] We believe that the Part 4 regulations can be amended with a simple fix by simply not specifying the "where" with respect to records maintenance, similar to regulations pertaining to FCMs and other registrants. We appreciate that the CFTC staff has issued exemptive relief permitting CTAs to use third-party recordkeepers. Nevertheless, amending the Part 4 regulations would greatly reduce administrative burden for CPOs and CTAs. Otherwise, registrants expend significant resources navigating the CFTC regulations to understand staff guidance and available exemptive relief, and amending or updating notice filings.

Accordingly, MFA requests that the Commission amend the CFTC Part 4 regulations to permit records entities to maintain records at locations other than their main business office and to engage third parties, use certain facilities or cloud-based applications, or enter into any other desired recordkeeping arrangements with third parties.

G. Exclude Compo Swaps from Calculation Under § 4.13(a)(3)

MFA requests that the Commission exclude compo swaps from calculation under § 4.13(a)(3) with respect to determining a pool's commodity interest position; and to issue related guidance. For regulatory simplification, we believe the Commission should allow a CPO to treat compo swaps as security-based swaps and exclude such products from its calculation of commodity interest positions for purposes of qualifying for an exemption from registration under § 4.13(a)(3), the *de minimis* trading exemption.

Market participants transact in total return swaps that allow one party to gain equity exposure to a stock or a narrow-based index of stocks that trade outside the United States; and generally, desire for payments under such total return swaps to be made in U.S. dollars ("**foreign**

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[53] Petition for Rulemaking to Amend CFTC §§ 1.31, 4.7(b) and (c), 4.23 and 4.22, Managed Funds Association, Investment Adviser Association, and Alternative Investment Management Association (Jul. 21, 2014), available at: https://www.managedfunds.org/wp-content/uploads/2014/07/Final-Petition.pdf.

[54] *See also* Comments on Proposed Recordkeeping, *supra* note 52.

equity total return swaps"). Compo swaps are foreign equity total return swaps, in which the currency translation is effected using the prevailing "spot" exchange rate at the time of such valuation or payment. While the Commission has held the view that compo swaps are mixed swaps,[55] we believe for purposes of calculating commodity interest positions under § 4.13(a)(3), the Commission should allow CPOs to treat compo swaps as security-based swaps and exclude compo swaps from the *de minimis* trading test under § 4.13(a)(3). The foreign exchange component of a compo swap is relatively minimal compared to the equity component; and these products are already regulated as security-based swaps. For regulatory simplification, we believe the Commission should exclude compo swaps from calculation under § 4.13(a)(3), and issue corresponding guidance.

DIVISION OF CLEARING AND RISK

H. Advocate for Congress to Amend the Bankruptcy Code to Facilitate Full Physical Segregation of Customer Collateral

MFA respectfully requests that the Commission advocate for Congress to amend the Bankruptcy Code to facilitate full physical segregation of customer collateral. Ensuring the protection of customers and their collateral was one of Congress's goals under the Dodd-Frank Act; however, the current treatment of "customer property" under the Bankruptcy Code prevents customers and their assets from being fully protected from the failure of an FCM or another of the FCM's customers.

MFA appreciates that the Commission remains vigilant about protection of investors and has adopted rules to address the regulatory issues revealed by the MF Global, Inc. ("**MF Global**") and Peregrine Financial Group, Inc. ("**Peregrine**") insolvencies.[56] Our members are fiduciaries to their investors and are customers themselves, and as counterparties to swaps transactions must post collateral to ensure performance of the contract.[57] Thus, the protection of such collateral is one essential element to preserving the financial integrity of the markets. As a result, we were very troubled by the MF Global and Peregrine events because the misuse or misplacement of customer funds in those situations resulted in customers experiencing a delay in the return or loss of substantial amounts of their assets.[58] Accordingly, we support thoughtful legislative and regulatory changes to strengthen protections of FCMs' customers.

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[55] Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement;" Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 Fed. Reg. 48,208 (Aug. 13, 2012), available at: https://www.gpo.gov/fdsys/pkg/FR-2012-08-13/pdf/2012-18003.pdf.

[56] *See* Commission final rule on "Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations", 78 Fed. Reg. 68506 (Nov. 14, 2013), available at: https://www.gpo.gov/fdsys/pkg/FR-2013-11-14/pdf/2013-26665.pdf.

[57] On uncleared swap trades, customers post initial margin to their dealer counterparties, and customers and their dealer counterparties exchange variation margin on a daily basis, depending on changes in the value of the swap.

[58] *See* Complaint, Commodity Futures Trading Commission v. Peregrine Financial Group, Inc., and Russell R. Wasendorf, Sr., No. 12–cv–5383 (N.D. Ill. July 10, 2012), available at:

Under current law, if an FCM becomes insolvent, it is possible a court might conclude that the customers' collateral is subject to the claims of all the FCM's customers on a *pro rata* basis (*i.e.*, non-defaulting customers would share equally in any shortfall). MFA believes that such treatment defeats the very purpose of collateral, *i.e.*, to provide assurance as to the integrity and performance of individual contracts. To remedy this concern, we ask that the Commission urge Congress to amend Chapter 7 of the Bankruptcy Code so that customer assets posted as collateral on cleared derivatives transactions are not considered "customer property"[59] subject to *pro rata* distribution upon an FCM's insolvency. Such an amendment would ensure that a customer receives prompt return of all of its assets upon such insolvency, rather than sharing in any shortfall due to the FCM's or another customer's default.

An amendment to the Bankruptcy Code would also enhance the effectiveness of existing and potential customer segregation protections. For example, the Commission has adopted the "legally segregated operationally commingled" model ("**LSOC**") for cleared swaps,[60] which is intended to protect the assets of non-defaulting customers from *pro rata* distribution. However, LSOC is a relatively new and untested segregation model. If a bankruptcy trustee or FCM's creditors challenge LSOC's intended protections in court after a customer's default leads to an FCM's insolvency, it is possible that a Bankruptcy Court judge will agree and hold that non-defaulting customers' collateral is "customer property" and is not shielded from *pro rata* distribution. By so amending the Bankruptcy Code as discussed above, Congress would help to alleviate this uncertainty and protect customers.

In addition, market participants are continuing to consider other enhancements to customer protections, such as optional full physical segregation of customer collateral.[61] MFA appreciates

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http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfpfgcomplaint071012.pdf. *See also* Report of the Trustee's Investigation and Recommendations, In re MF Global Inc., No. 11– 2790 (MG) SIPA (Bankr. S.D.N.Y. Jun. 4, 2012), available at: http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/mfglobaliinvestreport060412.pdf.

[59] *See* 11 U.S.C. §§752 and 766.

[60] *See* Commission final rule on "Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions", 77 Fed. Reg. 6336 (February 7, 2012), available at: http://www.gpo.gov/fdsys/pkg/FR-2012-02-07/pdf/2012-1033.pdf ("C**ommission Segregation Rules**"). LSOC requires an FCM to segregate its customers' collateral from its own property, but permits the FCM to commingle in an omnibus account all collateral of its customers.

[61] Full physical segregation is an arrangement that allows a customer to put its collateral in an account with a custodian or other third party in the customer's name, rather than have the customer's FCM hold its collateral, and thus, protects the customer in the event that its FCM or another customer becomes insolvent.

MFA notes that, even if LSOC is tested in a Bankruptcy Court proceeding and determined that customers' collateral is not "customer property" subject to *pro rata* distribution, LSOC still relies on the accuracy of an FCM's books and records to be effective. Under LSOC, if the FCM's books and records are not up-to-date or contain errors, an issue remains that there might be a delay in return of customer collateral or customer collateral might incorrectly be designated as FCM or another customer's property. For this reason, market participants continue to pursue full physical segregation options to provide the most robust protection of their collateral.

the Commission's efforts to enhance customer protections[62] by making valuable regulatory adjustments to reduce the likelihood of events similar to MF Global and Peregrine occurring in the future. However, we emphasize that work remains to ensure that customers receive appropriate and the same level of protections in the cleared market as some currently enjoy in the OTC derivatives market. Therefore, MFA believes that, if the Commission encouraged Congress to amend the Bankruptcy Code, it would significantly accelerate and enhance progress of customer protections and ultimately would facilitate customers' ability to customize and choose the level of protection that is appropriate for them.

I. Encourage European Regulators to Resolve Equivalence Issues under EMIR Article 13 and MiFIR Article 33

MFA requests that the Commission engage with European authorities and encourage them to resolve equivalence issues under Article 13 of the European Market Infrastructure Regulation ("**EMIR**")[63] and Article 33 of the Markets in Financial Instruments Regulation ("**MiFIR**"),[64] which prevent certain U.S. persons from satisfying their regulatory obligations under EMIR and MiFIR by complying with equivalent U.S. rules because those U.S. persons are not "established" in the U.S. This issue deeply affects the fund industry and the European banks with which they trade derivatives, and will hamper the ability of these market participants to continue to trade derivatives on a cross-border basis.

MFA applauds the efforts of the Commission and regulators in other jurisdictions to harmonize the scope of their derivatives rules and to recognize the equivalent rules of other jurisdictions to ensure that the trading of derivatives can continue to occur unimpeded on a cross-border basis. However, language in the text of Article 13 of EMIR and Article 33 of MiFIR could result in regulatory conflicts or duplication between European and U.S. rules. These regulatory conflicts may unintentionally prevent trading between European banks and funds organized in the Cayman Islands that have a U.S.-based manager or a U.S. principal place of business, and thus, are regulated in the U.S. as "U.S. persons" ("**Cayman Funds**"). As the vast majority of U.S.-based managers establish funds in the Cayman Islands or other offshore jurisdictions, this unintended consequence could impair a significant volume of business in the derivatives market.

Article 13(3) of EMIR provides as follows:

> *An implementing act on equivalence... shall imply that counterparties entering into a transaction subject to this Regulation shall be deemed to have fulfilled the obligations*

[62] *See supra* note 56.

[63] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:en:PDF.

[64] Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0600&from=EN.

contained in Articles 4, 9, 10 and 11 where at least one of the counterparties is established in that third country.

Similarly, Article 33(2) of MiFIR ("**Article 33**") provides as follows:

An implementing act on equivalence... shall have the effect that counterparties entering into a transaction subject to this Regulation shall be deemed to have fulfilled the obligation contained in Articles 28 and 29 where at least one of the counterparties is established in that third country.[65]

MFA believes that the European policymakers intended Article 13 and Article 33 to prevent circumstances from arising where parties to a derivative contract are required to comply with two separate regulatory regimes (*e.g.*, EMIR and the Dodd-Frank Act[66]). Specifically, these Articles seek to avert two undesirable regulatory outcomes. The first is where parties might be subject to directly conflicting rules in two jurisdictions if they enter into a trade and, accordingly, would be unable to trade with each other because by complying with one regime they would breach the requirements of another regime. The second is where parties to the trade may be subject to duplicative requirements in the two jurisdictions that achieve the same objectives but may have important substantive differences. Compliance with such duplicative rules creates inefficiencies, unnecessary expense and is contrary to the stated intention of Article 13 and Article 33.

Despite the intentions behind Article 13 and Article 33, a problem arises under both because of the notion of where a fund is "established" such that it can rely on an equivalence determination issued by the European Commission with respect to U.S. regulations. Specifically, the Commission regulates Cayman Funds (*i.e.*, non-U.S. funds with a U.S.-based manager or a U.S. principal place of business) as "U.S. persons".[67] However, based on a strict reading of EMIR and MiFIR, it is doubtful that market participants can treat these Cayman Funds as "established" in the U.S., since, even though these funds are subject to U.S. regulations, they are not organized in the U.S. As a result, if such Cayman Funds are not deemed "established" in the U.S., the consequence is that, when Cayman Funds trade derivatives with European dealers, neither the Cayman Funds nor their European dealer counterparties would be able to benefit from Article 13 or Article 33 and rely on such equivalence acts with respect to U.S. regulations.

MFA emphasizes that these fact patterns are reflective of a significant volume of business in the derivatives market, and has raised this concern with the European Commission, ESMA, the SEC, and the Cayman Islands Monetary Authority. Therefore, this issue should not be underestimated and could have serious consequences on the business of European banks and

[65] MFA notes that the Articles of MiFIR referred to in the foregoing address the following regulatory obligations: (1) obligation to trade on regulated markets, multilateral trading facility, or organised trading facility (Article 28); and (2) clearing obligation for derivatives traded on regulated markets and timing of acceptance for clearing (Article 29).

[66] *See supra* note 3.

[67] MFA notes that we support the Commission regulating such funds as "U.S. persons".

Cayman Funds as they may cease transacting with each other in order to avoid duplicative or conflicting rules. Such unintended consequences would be contrary to the interests of global trading as well as ease of access to markets. Accordingly, we emphasize that resolution of this equivalence issue is of equal importance to, and affects both, Cayman Funds as well as European dealers. We would appreciate any assistance that the Commission can provide in urging European authorities to resolve this issue.

J. Focus on and Protect the Interests of Customers in Regulations on CCP Recovery and Resolution

MFA believes that any regulations addressing the recovery or resolution of CCPs should protect the assets and interests of customers. As the Commission continues to consider whether it should issue regulations on this issue, we urge the Commission to ensure that it is protecting customers by allowing certain key principles to guide it. In particular, discussions on this issue have primarily taken place among regulators, CCPs, and FCMs, with customers being largely excluded, even though use of customer assets has been emphasized as a potential loss allocation tool. Because MFA's members manage the assets of their investor and taxpayer clients, any use of customer assets during a CCP's recovery or resolution results in losses to these investors and taxpayers, which is contrary to the core principles of the Dodd-Frank Act.

Issues related to the recovery and resolution of CCPs have become an area of focus for regulators in the U.S. and other jurisdictions. Because CCPs are financial market infrastructures that allow central clearing to occur, as clearing has risen in importance so too has the focus on the safety and soundness of CCPs, as well as the steps that should be taken in the circumstances, however rare, where a CCP experiences material financial distress. Because customers are significant users of CCPs and their clearing services (albeit indirect users), customers' capital is at risk if a CCP fails. Thus, customers warrant substantial protection and have a significant interest in having their views taken into account on these issues. Given the implications that a CCP's failure would have on customers, we think it extremely important for relevant authorities to consult, reflect the views of, and balance the assumed risks of, all market participants, including customers, as discussions and rulemaking around these issues progress.

Set forth below are key principles that MFA believes should guide the Commission and other authorities across the globe as they consider what requirements they will impose on CCPs with respect to their recovery or resolution. These key principles reflect our views as to where we believe the appropriate balance is between the safety and soundness of CCPs and the protection of customers and their assets. MFA believes that each key principle is a critical component of ensuring the continued functioning of the financial markets while any CCP is in distress.

(1) CCPs should not use customer assets as part of any loss allocation tool.

Regardless of whether a failing CCP will seek recovery or begin resolution, a central question is whose assets the CCP will use to bolster its recovery or facilitate its resolution. Some clearing members are recommending that CCPs use customer assets (in particular customer variation margin ("**VM**") haircutting) as a preferred solution. MFA strongly objects to use of customer IM or VM during a CCP recovery or resolution. Policy makers and regulators seem to agree that IM haircutting is not a viable option, since it is impermissible under the rules and law of many jurisdictions.[68] However, we are aware that, despite our strong objections, policy makers or regulators have contemplated permitting a stressed CCP to use VM haircuts to allocate losses to its participants more broadly after the CCP has used all other financial resources available to it.[69] In discussions about using VM haircutting as a loss allocation tool, we believe that the mechanism by which CCPs would allocate any such VM haircuts has been overlooked, and could have severe consequences with respect to how losses are actually distributed among market participants (as recognized by at least one clearing member).[70] Therefore, we emphasize that, if policy makers or regulators ever permit a stressed CCP to employ haircuts with respect to its participants' VM, such VM haircuts: (1) should be used as a last resort, (2) should not affect customers disproportionately as compared to other CCP participants, and (3) should only be applied using equitable approaches that allocate losses to participants in proportion to their use of the CCP.

(2) Customers must have certainty as to whether a failing CCP will be recovered or resolved.

A core, polarizing issue in the debate around CCPs in distress is whether to allow such CCPs to fail and be resolved or whether to encourage the CCP's recovery. A question underlying this debate is whether a systemically important CCP is "too big to fail". MFA believes that there is no universal right answer to this question.

Whether the CCP will resolve or seek recovery, we emphasize that the overarching goal must be to provide market participants with prompt certainty. Currently, CCP rulebooks are the only established guidelines around whether a distressed CCP must seek recovery or go into resolution. However, our understanding is that the rulebooks provide CCPs with significant flexibility. The rulebooks allow the CCPs to determine, for example, when to conduct an auction and who can participate or what the timeframe is after becoming distressed for the CCP to decide whether to seek recovery or be resolved. Therefore, it is important that CCP rulebooks have less flexibility and instead include clear, robust, pre-determined criteria that enable CCPs to make prompt determinations between recovery and resolution. Such criteria will allow the CCP to make

[68] *See e.g.*, U.S. Bankruptcy Code, 7 U.S.C. §741-753 and §761-766; Sections 724 and 763 of the Dodd-Frank Wall Street Reform and Consumer Protection Act; and Commission Segregation Rules *supra* note 60.

[69] *See* Committee on Payments and Market Infrastructures and the Board of the International Organization of Securities Commissions principles for "Recovery of financial market infrastructures" dated October 2014, at 18-19, discussing CCPs' possible use of VM haircutting as a loss allocation tool and the reasons why clearing members prefer CCPs to use gains-based methods, available at: http://www.bis.org/cpmi/publ/d121.pdf.

[70] *See* JPMorgan Chase & Co. Perspectives, *What is the Resolution Plan for CCPs?*, September 2014, at 2, explaining that VM gains haircutting "is equally flawed as a sole solution to resolution" because it could have unexpected consequences. In particular, the Whitepaper asserts that end users who expected cash payments would be likely to liquidate assets in order to raise funds, which would depress the value of these assets and weaken the market, creating a pro-cyclical scenario that could further destabilize a collapsing market. Available at: http://www.jpmorganchase.com/corporate/About-JPMC/document/resolution-plan-ccps.pdf.

prompt determinations, and thus, provide market participants with the certainty they need to be able to manage their own portfolios and assets accordingly.

(3) Customers must have affirmative representation on CCP decision-making bodies.

The imposition of mandatory central clearing and the potential magnitude of losses that customers would suffer if a CCP fails (especially if CCPs use customer assets as a loss allocation tool) emphasize the need for customers to have affirmative representation on CCP governing bodies, including CCP boards, risk committees, and default management committees.

Customers should have their views reflected in the critical decisions of CCP governing bodies. Customers are crucial stakeholders in the cleared derivatives markets and have interests that are aligned with the core CCP goals of mitigating systemic risk and increasing transparency, efficiency, and competition. Customers also have sophisticated derivatives product and risk management expertise and significant knowledge about the issues market participants encounter when seeking access to clearing and best execution. Therefore, MFA strongly believes that, to address imbalances in CCP governance and act as a counterbalance to historically aligned and concentrated clearing member interests, regulations should mandate that customers have affirmative representation on CCP boards and committees and that no group's representation may constitute a controlling majority.

(4) Customers must be allowed to participate in CCP default management auctions.

It is important for regulators to take steps to expand opportunities for customer participation in CCP default management auctions. A CCP's auction is a critical piece of its default management process, which is typically open only to clearing members (*i.e.*, customers are excluded from participation). In particular, in the case of a clearing member default, a CCP may use an auction to coordinate the orderly transfer of defaulted trades by allowing non-defaulting participants to bid on those trades.

At a fundamental level, it makes sense to allow customers to participate in these auctions. First, based purely on the principle of supply-and-demand, the more demand that can be generated for the auctioned trades, the higher the likelihood that a market clearing auction price is achieved, and the more likely the auction will be successful for the CCP. Second, allowing customers to participate in CCP auctions ensures that more sources of private capital are available, which helps to minimize potential negative externalities of the CCP's distress, such as the possibility that the CCP would need to access public capital to facilitate its recovery or resolution. Lastly, customer participation in CCP auctions increases the likelihood that there are market participants in a sufficiently strong position to robustly bid in the auction (as compared to only allowing a relatively homogenous group of clearing members to participate that may be similarly impaired by market events).

(5) CCPs should have substantial "skin in the game" to align their incentives.

It is important that a CCP be exposed to the loss of its own funds as part of its default waterfall.[71] The guarantee fund consisting of clearing member contributions and the separate CCP contributions that form part of the CCP's default waterfall are the CCP's principal mechanisms for protecting itself from the failure or default of one of its participants. While each clearing member must contribute a certain amount of resources to a CCP's guarantee fund, the CCP's assets are included to a more limited extent.

Therefore, requiring CCPs to pre-fund capital contributions to the guarantee fund (*i.e.*, have "skin in the game") would have important benefits. Most importantly, it would align the incentives of the CCP with its direct and indirect participants by ensuring that the CCP has as significant an interest as its participants in avoiding default. In addition, contributing such additional capital would increase the CCP's financial resources, and thus, would reduce the potential for the CCP to default in the event of a participant failure.

(6) Regulators should set standards for, and have robust oversight of, CCP stress testing.

Stress testing is an essential component of CCP risk management that allows the CCP to verify the adequacy of its financial resources (*i.e.*, posted margin, guarantee fund contributions, and CCP capital contributions) and financial stability during extreme or stressed market situations. Although CCPs currently engage in stress testing, each CCP is able to design and conduct its own stress tests, which includes determining the scope, frequency, and duration of such tests. Therefore, stress testing procedures can vary from CCP to CCP and may not be sufficiently robust in all areas (*e.g.*, may not test sufficiently for certain stressed situations).

MFA believes that to augment such regulatory enhancements, regulators should impose specific minimum criteria and standards for CCPs' stress tests as part of CCPs' ordinary business as well as CCPs' recovery planning. We believe it important that regulators impose a uniform, minimum set of standards that all CCPs must apply on a periodic (but sufficiently frequent) basis and regulators should include review of those procedures and stress tests as part of regular CCP exams.

K. Recalibrate and Reduce Initial Margin Requirements to Better Reflect the Actual Risk of Certain Non-Clearable Swap Products

MFA believes that the Commission needs to recalibrate and appropriately tailor the IM requirements for uncleared swaps to reflect the actual risk posed by certain non-clearable swap products, such as total return swaps ("**TRS**") for complex equity trades. Many hedge funds trade such TRS to achieve exposure to equities. However, as banks do not trade such TRS among

[71] For purposes of this principle, when we refer to CCP "skin in the game", we mean CCP capital from all available resources, such that the incentives of the CCP, its shareholders, and its participants are all aligned.

themselves, our requested tailored revision to IM requirements for such products would present relatively little systemic risk. Therefore, funds that use non-clearable TRS should not be penalized by having to over-collateralize them based on the higher IM requirements that will be coming into effect for their uncleared trades on September 1, 2019 or 2020. The underlying policy objective for the higher uncleared margin requirements is to encourage clearing swaps that are suitable for clearing. That policy objective has a punitive and disproportionate effect on buy-side market participants who trade non-clearable TRS and collateralize them based on the actual risk posed by such products.

DIVISION OF MARKET OVERSIGHT

L. Reduce Complexity of Cleared Swap Reporting Requirements by Eliminating Alpha Swap Reporting

MFA believes the CFTC should eliminate alpha swap reporting requirements to reduce the reporting complexities of its cleared swaps reporting regime and to streamline the data actually reported without sacrificing the amount of information available to the CFTC regarding the entire life cycle of a swap. As you noted in a recent interview with *Risk.net*,[72] the Commission only needs the final information reported by the CCP concerning the beta/gamma swaps comprising a cleared swap for effective oversight. As explained in MFA's prior comment letters, MFA believes there is no need for the reporting of an original "alpha" swap for any swap that is executed with the intention to be cleared.[73]

BANK CAPITAL REQUIREMENTS AFFECTING CUSTOMER CLEARING

M. Recalibrate Leverage Ratio for Cleared Derivatives to Allow Offset for Segregated Client Initial Margin

MFA seeks the CFTC's help as a voting member of FSOC to achieve an important recalibration in the leverage ratio for cleared derivatives that will have a profound impact on customer clearing. As you noted in your recent public remarks, the CFTC has an influential role to play in achieving recalibrated bank regulatory capital requirements and leverage ratios to "better

[72] *See supra* note 7.

[73] *See* letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, and Adam Jacobs, Director, Head of Markets Regulation, Alternative Investment Management Association (AIMA), to Melissa D. Jurgens, Secretary, CFTC, on May 27, 2014, on Review of Swap Data Recordkeeping and Reporting Requirements, available at: https://www.managedfunds.org/wp-content/uploads/2014/05/CFTC-Swap-Data-Reporting-Rules-Final-MFA-AIMA-Letter.pdf; *see also* letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, and Jiri Krol, Deputy CEO, Global Head of Government Affairs, AIMA, to Mr. Christopher Kirkpatrick, Secretary, CFTC, on October 30, 2015, on Amendments to Swap Data Recordkeeping and Reporting Requirements for Cleared Swaps, available at: https://www.managedfunds.org/wp-content/uploads/2015/11/CFTC-Proposed-Amendments-for-Cleared-Swap-Data-Reporting-MFA-AIMA-Final-Letter.pdf.

balance systemic risk concerns with healthy economic growth and American prosperity."[74] While MFA supports the Basel Committee on Banking Supervision's ("**Basel Committee**") proposed revision to use the Standardized Approach for Measuring Counterparty Credit Risk Exposures ("**SA-CCR**") for its Basel III leverage ratio ("**Leverage Ratio**") framework, we are concerned with the Leverage Ratio's treatment of segregated IM for centrally cleared derivatives exposure, which does not recognize the exposure-reducing effect of customers' segregated IM. To ensure the continued affordability and robustness of customer clearing in the U.S., MFA suggests that the leverage ratio rules should be recalibrated to allow clearing members of CCPs to offset segregated IM when calculating exposure.

The Basel Committee's transition from the Current Exposure Method to the SA-CCR method should be a positive for end-clients, because SA-CCR more accurately captures exposures that clearing members face when providing clearing services to clients. However, MFA has strong concerns about the Basel Committee's treatment of segregated IM for centrally cleared derivatives exposure under the Leverage Ratio, because it will significantly increase clearing costs, cause customers to reduce their hedging activities to levels that are inadequate to manage their risks, and make central clearing of derivatives increasingly less accessible and less affordable for end-users.

CCPs' risk management methodologies are predicated on the collection of IM and VM from clearing members and customers in order to collateralize potential exposure. In addition, direct clearing members guarantee payment of their customers' obligations to the CCP. Because the IM is the customer's money, CFTC rules require clearing members to segregate customer funds from the clearing member's own assets.

While the Basel Committee's framework captures a clearing member's guarantee to the CCP as an off-balance sheet exposure, the Leverage Ratio fails to provide an offset that recognizes the exposure-reducing effect of customers' segregated IM. According to the Basel Committee, the reason for the lack of an offset for customer IM is that segregated customer IM not only offsets exposures, but also can be used by the clearing member for further leverage.

In the U.S., segregation rules severely restrict the ability of IM to be held in anything other than extremely low-risk and extremely liquid assets, assuring that it is always available to absorb losses ahead of the bank. Moreover, the substantial majority of segregated IM is posted to the CCP, and therefore, is entirely outside the control of the clearing member.

The Leverage Ratio's failure to recognize the purpose of segregated IM is a threat to the use of cleared derivatives by customers. Because of the lack of offset, clearing members will incur large Leverage Ratio exposures, which will likely raise prices for customer clearing significantly. This substantial cost increase may cause customers to reduce their hedging activities, which could result in price increases and volatility for food, gasoline, and other consumer goods.

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[74] *See* Giancarlo Boca Speech, *supra* note 2.

On November 3, 2016, MFA joined a coalition letter signed by 14 other industry bodies representing clearing members, asset managers, insurance companies, commodity end-users, hedge funds, derivatives exchanges, and CCPs.[75] The letter expressed the coalition's concerns that the Leverage Ratio will harm the strength and stability of the cleared derivatives markets worldwide, unless it is amended to recognize the exposure-reducing effect of the segregated IM that clearing banks collect from their clients. The coalition sent the letter to the Chairman of the Basel Committee, as well as to the Chairman of the FSB and the Chairman of the Group of Governors and Heads of Supervision.

In the letter, the coalition expressed its willingness to accept further conditions that the Basel Committee may impose for client segregated IM, or a limited recognition so that money that goes to the CCP may be recognized under the Leverage Ratio. The coalition also expressed concerns that the Leverage Ratio could raise barriers to porting client positions from a failing clearing member, because the ported clients' segregated IM would increase a transferee clearing member's capital requirements at a time of system-wide stress, when firms would already face capital and liquidity challenges. Lastly, the coalition noted that a clearing member's inability to recognize the segregation of client IM in the Leverage Ratio inappropriately increases the capital cost of client clearing, which undermines a key reform goal to use the safeguards of central clearing for standardized derivatives contracts.

Separately, on November 23, 2016, the EC proposed changes to the EU capital requirement regulation and directive that would, among other things, allow clearing firms to reduce the Leverage Ratio exposure measure by the IM received from clients for cleared derivatives. MFA applauds this EC proposal.

To ensure the continued affordability and robustness of customer clearing in the U.S., MFA seeks the CFTC's help in its capacity as a voting member of FSOC to encourage the Board of Governors of the Federal Reserve, the Federal Deposit Insurance Corporation, and the Office of Comptroller of the Currency to consider the EC's proposal and industry-wide concerns in their rulemaking processes, and provide an offset for clearing members to the extent that customer IM is posted to the CCP, or is segregated under the U.S. regulatory regime.[76]

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[75] Available at: https://www.managedfunds.org/wp-content/uploads/2016/11/Letter-to-BCBS-GHOS-FSB-from-Participants-in-Cleared-Derviatives-Markets-Final.pdf.

[76] MFA notes that Federal Reserve Governor Jerome Powell recently called for a recalibration of the Leverage Ratio in the U.S.at its Global Finance Forum in Washington, D.C. on April 20, 2017, pointing to the damaging impact the SLR is having on client clearing.

MFA appreciates the opportunity to provide these comments, and we look forward to continuing to provide what we intend as useful and constructive comments on pending and future Commission rulemakings. If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact Jennifer Han, Associate General Counsel, or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

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

CC: The Hon. Sharon Bowen, Commissioner
Mike Gill, Chief of Staff, Acting Chairman
Eileen Flaherty, Director, Division of Swap Dealer and Intermediary Oversight
John Lawton, Acting Director, Division of Clearing and Risk
Amir Zaidi, Director, Division of Market Oversight

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April 12, 2011

Via Electronic Mail: http://comments.cftc.gov

David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Proposal to Rescind Sections 4.13(a)(3) and (a)(4); RIN 3038-AD30

Dear Mr. Stawick:

Managed Funds Association ("MFA")[1] appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "Commission" or "CFTC") on its notice of proposed rulemaking on amendments to compliance obligations for commodity pool operators ("CPOs") and commodity trading advisors ("CTAs") (the "Release").[2] In this letter, we provide comments on the Commission's proposal to rescind sections 4.13(a)(3) and (a)(4) of the Commission's regulations. We are also submitting comments under separate cover on the Commission's other proposed amendments and regulations on CPO and CTA reporting and compliance obligations in the Release.

I. Proposed Amendments to Rescind the Sections 4.13(a)(3) and (a)(4) Exemptions from Registration

The Commission proposes to rescind certain exemptions from registration provided in sections 4.13(a)(3) and (a)(4) (together, the "Private Pool Exemptions").[3] From the Release, we understand that the Commission believes this action would be consistent with the tenor of the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[4] We, however, believe

[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $1.9 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

[2] 76 FR 7976 (Feb. 11, 2011).

[3] 76 FR 7976, 7985. Section 4.13(a)(3) provides that a person is exempt from registration as a CPO if the interests in the pool are exempt from registration under the Securities Act of 1933 and offered only to qualified eligible persons ("QEPs"), accredited investors, or knowledgeable employees, and the pool's aggregate initial margin and premiums attributable to commodity interests do not exceed five percent of the liquidation value of the pool's portfolio. 17 CFR 4.13(a)(3). Section 4.13(a)(4) provides that a person is exempt from registration as a CPO if the interests in the pool are exempt from registration under the Securities Act of 1933 and the operator reasonably believes that the participants are all QEPs. 17 CFR 4.13(a)(4).

[4] 76 FR 7976, 7978. The Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376.

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that with respect to certain entities: (1) rescission of the Private Pool Exemptions is unnecessary to achieve the public policy objectives of the Dodd-Frank Act; (2) the preservation of the Private Pool Exemptions is consistent with and embedded in current law and inter-agency comity; and (3) the Commission will still receive information it needs from the SEC and exchanges even if the Private Pool Exemptions are retained. We are concerned that rescission of the Private Pool Exemptions would: increase dramatically (for our members and for other participants in the U.S. futures markets) the cost of responsibly operating an investment adviser in the United States; decrease the competitiveness of U.S.-based advisers *vis-à-vis* their European and Asian-based competitors by imposing unnecessary costs and negligible benefits to the marketplace; and provide limited incremental regulatory benefit to the Commission and the other federal marketplace regulators.

We note the significant fiscal constraints facing the Commission, the pressing new regulatory obligations imposed by the Dodd-Frank Act on the Commission, and the President's Executive Order on Improving Regulation and Regulatory Review[5] which, while not directly applicable to the Commission, encourages every agency to consider eliminating unnecessary or duplicative regulations. Given the significance of these pressures, we suggest that the Commission's proposal to eliminate long-standing exemptions without compelling findings or failure in the current regime seems like a poor use of scarce regulatory resources.

A detailed discussion follows as we respectfully suggest that the Commission should retain the exemption in: (1) section 4.13(a)(4) for investment advisers who are or will be registered with the Securities and Exchange Commission ("SEC") (or their commonly controlled affiliates);[6] and (2) section 4.13(a)(3) for SEC-registered investment advisers whose underlying fund does not "engage primarily" in trading commodity interests.

A. Rescission of the Private Pool Exemptions is Unnecessary to Achieve the Public Policy Objectives of the Dodd-Frank Act

The Dodd-Frank Act enhanced the Commission's rulemaking and enforcement authorities by expanding the scope of its regulatory jurisdiction to include swaps and by creating new financial regulatory entities.[7] Accordingly, the Commission has stated that one of the primary purposes of the Dodd-Frank Act is to promote transparency with respect to the activities of market participants;[8] and that it wants to implement a parallel registration and reporting regime for pooled investment vehicles and their operators and/or advisors as the SEC has implemented for investment advisers under the Dodd Frank Act.[9] We appreciate the Commission's initiative to amend its regulations in the spirit of the Dodd-Frank Act and would like to offer a number of suggestions and comments to further those objectives without hampering our members' competitiveness or ability to focus on managing investors' assets.

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[5] Executive Order – Improving Regulation and Regulatory Review, dated January 18, 2011, *available at:* http://www.whitehouse.gov/the-press-office/2011/01/18/improving-regulation-and-regulatory-review-executive-order.

[6] Oftentimes, private investment funds are structured such that the general partner or commodity pool operator is a separate legal entity from the adviser entity that registers with the SEC. We believe that if the private investment fund is advised by an SEC-registered adviser, then under section 4.13(a)(4) the private investment fund's adviser or general partner should not have to also register as a CPO.

[7] *See* Title VII of the Dodd-Frank Act.

[8] 76 FR 7976, 7985.

[9] 76 FR 7976, 7978.

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MFA has consistently supported intelligent and well-informed regulation of the U.S. securities and futures markets.[10] From the beginning of the 2009-2010 legislative process, we took an early and unambiguous stand in favor of mandatory investment adviser registration, which in many respects has been codified in the Dodd Frank Act. We also consistently have endorsed the notion that our regulators need a necessary amount of market and participant information and appropriate funding to discharge their regulatory responsibilities effectively. MFA members have met with numerous legislators and regulators in an effort to strengthen the current regulatory framework and to make proposed reforms workable.

However, we do not believe that rescission of the Private Pool Exemptions for entities registered with the SEC under the Investment Advisers Act of 1940 ("registered advisers"), which is not a step mandated (or, in our reading, even expressly contemplated) by the Dodd-Frank Act, is necessary to achieve the public policy objectives of the Dodd-Frank Act. In fact, we are very concerned that such a rescission would increase costs, reduce our members' competitiveness with respect to non-U.S. advisers, and cause unnecessary, duplicative and burdensome regulation.

1. Amending Section 4.13(a)(4) – Sophisticated Investor Exemption

The current registration exemption under section 4.13(a)(4) provides relief from CPO registration for a CPO if the interests in the pool are exempt from registration under the Securities Act of 1933 (the "Securities Act") and the participants are all qualified eligible persons, *i.e.*, highly sophisticated investors. The Commission adopted section 4.13(a)(4) and other provisions providing relief from registration in 2003 "to encourage and facilitate participation in the commodity interest markets by additional collective investment vehicles and their advisers, with the added benefit to all market participants of increased liquidity."[11] We believe section 4.13(a)(4) serves that objective and we are concerned that repeal of the exemption would require the adviser (or its commonly controlled affiliates) to go to the unnecessary expense of registering with the CFTC. As a consequence the repeal of the exemption could discourage market participants from participation in the commodity interest markets. As discussed in more detail in the sections below, dual registration is inefficient, unnecessary and costly, and provides investors with little additional benefit. Currently section 4.13(a)(4) is available to any market participant, regardless of whether that market participant is registered with the SEC. To address the Commission's concern that through its section 4.13(a)(4) exemption market participants could fall outside of the oversight of any regulators, we recommend that the Commission retain the current exemption provided in section 4.13(a)(4) provided that the pool has an investment adviser registered or that will be registered with the SEC.[12] In this way, the Commission would ensure that the adviser was subject to regulatory oversight

[10] *See*, MFA's website for written statements before Congressional hearings and regulatory comment letters: www.managedfunds.org. *See e.g.*, Testimony of the Hon. Richard Baker, President and Chief Executive Officer, MFA before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Entities, Committee on Financial Services, U.S. House of Representatives, May 7, 2009 at 5, *available at:* http://www.managedfunds.org/downloads/FINAL%20Written%20Testimony%20for%20May%207%20hearing.pdf.

[11] 68 FR 47221, 47223 (August 8, 2003).

[12] *See* letter from Robert E. Plaze, Associate Director, SEC, to David Massey, President, North American Securities Administrators Association, Inc., dated April 8, 2011 (stating that the Commission is considering providing investment advisers with more time to come into compliance with the registration requirements under the Dodd-Frank Act) *available at:* http://www.sec.gov/rules/proposed/2010/ia-3110-letter-to-nasaa.pdf.

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and the Commission would have access to information on private funds investing in commodity interests without unduly burdening the market.[13]

2. Amending Section 4.13(a)(3) – Not "Engaged Primarily" in Trading Commodity Interests

The current registration exemption under section 4.13(a)(3) provides relief from CPO registration for a CPO if the interests in the pool are exempt from registration under the Securities Act and offered only to qualified eligible persons, accredited investors, or knowledgeable employees, and the pool's aggregate initial margin and premiums attributable to commodity interests do not exceed five percent of the liquidation value of the pool's portfolio. We propose that the Commission amend section 4.13(a)(3) to provide pool operators with relief from registration in a manner consistent with the Dodd-Frank Act. In our view, consistent with the Dodd-Frank Act, as discussed further below, a pool operator should not have to register with the CFTC as a CPO if its commodity pool is not "engaged primarily" in trading commodity interests.[14] We respectfully urge the Commission to coordinate with the SEC as it develops further guidance on the meaning of "engaged primarily" and for the Commissions to harmonize registration and compliance requirements to the extent possible to lessen the burden on those firms that are required or choose register with both regulators.

We propose the Commission adopt guidance providing that a commodity pool will not be presumed to be "engaged primarily" in trading commodity interests if its initial margin and premiums required to establish the commodity interest positions do not exceed 20% of the pool's average annual net asset value (net of any debt), measured on a rolling quarterly basis (a "20% Test");[15] and accordingly, that such CPO would not have to register with the Commission. The Commission could also stipulate that in order for such exemption to apply to a CPO, the commodity pool must have an investment adviser registered with the SEC.

While there may be a few different logical formulas for analyzing whether a commodity pool is "engaged primarily" in trading commodity interests, we favor a 20% Test as it would provide market participants with a "bright-line" test that is practical to administer. For the sake of comparison, the SEC staff, through No-Action letters, has provided guidance on the meaning of being "engaged primarily" in the business of investing securities for purposes of determining whether an entity is an investment company.[16] In its analysis of determining whether an entity was otherwise engaged primarily in the business of investing in securities so as to be an investment company, the SEC considered the composition of the entity's assets, the sources of its income, the area of business in which it anticipated realization of the greatest gains and exposure to the largest risks of loss, the activities of its officers and employees, its representations, its intentions as revealed by its operations, and its historical development

[13] *See infra* discussion in section C.

[14] *See, e.g.,* Section 749 of the Dodd-Frank Act (defining "engaged primarily").

[15] *Cf.* Section 3(a)(C) of the Company Act (defining an "investment company" to be an issuer which is in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value **exceeding 40 percentum** of the value of such issuer's total assets . . . .).

[16] Section 3(b)(1) of the Investment Company Act of 1940 excludes from the definition of investment company any issuer engaged primarily in a business or businesses other than investing, reinvesting, owning, holding or trading in securities, either directly or through wholly-owned subsidiaries.

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(the "Peavey Test").[17] Previously, we have supported and endorsed with respect to advisers,[18] the SEC's approach for determining the meaning of "engaged primarily" for purposes of determining whether an entity is an investment company. We have determined, however, that a 20% test is superior to the Peavey Test for analyzing whether an entity is engaged primarily in trading commodity interests because it provides market participants with greater regulatory certainty and is a less subjective test. We believe a framework based on the 20% Test would promote efficiency, reduce overlap, help prioritize regulatory resources, and reduce compliance cost to advisers and their customers. Accordingly, we recommend the Commission adopt a 20% Test in presuming that a commodity pool is not "engaged primarily" in trading commodity interests.

B. The Preservation of the Private Pool Exemptions is Consistent with and Embedded in Current Law and Inter-Agency Comity

We believe that MFA's position on the preservation and amendment of the Private Pool Exemptions is consistent with the spirit and letter of the Dodd-Frank Act, and is very much in keeping with the amicable division of responsibilities between the Commission and the SEC that Congress intended.

The section 4.13(a)(4) exemption operates under the same rationale and principle as Regulation D under the Securities Act and section 3(c)(7) of the Investment Company Act of 1940 (the "Company Act")—that sophisticated investors have the ability to fend for themselves and do not require the protections of registration under the federal securities laws.[19] The Dodd-Frank Act left these provisions intact and rather than amend the Company Act, Congress chose to achieve regulatory oversight of private funds through investment advisers registered with the SEC. We believe this is indicative of Congress's intent for the regulatory framework to continue to provide relief from registration with respect to private offerings and to maintain a private offering framework. Rescission of section 4.13(a)(4) would be inconsistent with the private offering framework established under the Securities Act as it would eliminate the availability of a private offering with respect to an investment vehicle investing in commodity interests—singling out commodity investment vehicles from all other types of investments.

Prior to enactment of the Dodd-Frank Act, as an acknowledgment to the burdens and redundancy of dual registration, both the CEA and Advisers Act contained exemptions to avoid dual registration as an adviser.[20] During the Dodd-Frank legislative process policy makers again considered this division of

[17] *See* Peavey Commodity Futures Fund, SEC No-Action Letter (pub. avail. June 2, 1983), 1983 SEC No-Act. LEXIS 2576 ("Peavey") (determining the primary engagement of a fund for purposes of the Investment Company Act of 1940). *See also*, Tonopah Mining Co. of Nevada, 26 S.E.C. 426 (1947) (adopting a five factor analysis for determining an issuer's primary business for purposes of assessing the issuer's status under the Investment Company Act of 1940).

[18] *See* letter from Richard H. Baker, CEO and President, MFA, to Elizabeth M. Murphy, Secretary, SEC, and David A. Stawick, Secretary, CFTC, on September 25, 2009 in relation to "Harmonization of Regulation; File No. 4-588", *available at:* http://www.managedfunds.org/downloads/MFA%20response%20to%20SEC.CFTC.9.25.09.pdf.

[19] *See* Section 4(6) of the Securities Act; *SEC v. Ralston Purina Co,*, 346 U.S. 119 (1953) (indicating that the application of the non-public offering exemption depended on whether the offerees were able to fend for themselves and had access to the same kind of information that would be disclosed in registration); *and* Securities Exchange Act Release 8041 (Dec. 19, 2001), Defining the Term "Qualified Purchaser" under the Securities Act of 1933, *available at:* http://www.sec.gov/rules/proposed/33-8041.htm.

[20] *See* Section 4m(3) of the CEA; *and* section 203(b)(6) of the Advisers Act.

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labor between the Commissions and the burden on registrants as earlier drafts of the Dodd-Frank Act sought to repeal the availability of section 203(b)(6) of the Advisers Act, an exemption for registered CTAs from registration as an investment adviser, for an adviser to a private fund.[21] Section 203(b)(6) exempts from registration any investment adviser that is registered with the Commission as a CTA whose business does not consist primarily of acting as an investment adviser (and does not act as an investment adviser to a registered investment company or a business development company).

Ultimately, the Congress chose not only to retain the exemption from registration under section 203(b)(6) of the Advisers Act, but to amend the section to exempt from registration any investment adviser that is registered with the Commission as a CTA and advises a private fund, provided that, if after the date of enactment of the Private Fund Investment Advisers Registration Act of 2010, the business of the advisor should become predominately the provision of securities-related advice, then such adviser shall register with the SEC.[22] Simultaneously, Congress amended CEA section 4m(3) to provide that registration as a CTA (amended language in italics):

> . . . shall not apply to any commodity trading advisor that is registered with the Securities and Exchange Commission as an investment adviser whose business does not consist primarily of acting as a commodity trading advisor, as defined in section 1a of this title, and that does not act as a commodity trading advisor *to any commodity pool that is engaged primarily in trading commodity interests.*
>
> *. . . a commodity trading advisor or a commodity pool shall be considered to be 'engaged primarily' in the business of being a commodity trading advisor or commodity pool if it is or holds itself out to the public as being engaged primarily, or proposes to engage primarily, in the business of advising on commodity interests or investing, reinvesting, owning, holding, or trading in commodity interests, respectively.*[23]

If it were the intention of Congress to require dual registration, the Dodd-Frank Act would have repealed the respective exemptions under the CEA and the Advisers Act. The fact that Congress preserved the exemptions and exempted from registration a CTA advising any commodity pool that is not "engaged primarily" in trading commodity interests is indicative of its intent to maintain a regulatory framework that reduces duplicative regulation. In the same vein, we believe the amended language is evidence that Congress did not intend for an operator of a commodity pool not engaged primarily in trading commodity interests to be registered as a CPO. Otherwise, Congress would not have exempted from registration CTAs advising such entities.

Without the availability of the Private Pool Exemptions, it is unclear whether the operating entity of a private fund that engages in even the lowest level of hedging through the use of futures or swaps would have toregister as a CPO. The Dodd-Frank Act defines "commodity pool" as any investment trust, syndicate, or similar form of enterprise operated for the purpose of trading in commodity interests, including any commodity for future delivery, security futures product, or swap.[24] Rescinding the Private Pool Exemptions would require an entity (or its commonly controlled affiliates) that is registered with the

[21] *See e.g.,* Section 5003 of H.R. 4173 EH, 111th Cong. (2009).

[22] Section 203(b)(6) of the Advisers Act.

[23] Section 749 of the Dodd-Frank Act.

[24] Section 721(a)(5) of the Dodd-Frank Act.

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SEC as an investment adviser with a pool consisting of only highly sophisticated investors or that does not primarily trade commodity interests to register as a CPO. Title VII of the Dodd-Frank Act also brings under the Commissions' regulatory regimes entities that trade swaps and security-based swaps. Many fund advisers will find that without an exemption from registration they will need to register with both Commissions and be subject to duplicative regulation. Thus, rescission of the Private Pool Exemptions would likely require many investment advisers to dually register as CPOs and potentially frustrate the intention of the Dodd-Frank Act to limit duplicative regulation.

Given that the Commission will have access to a great deal of information on private pools through Form PF and other forms of reporting, we believe the costs associated with rescission of the Private Pool Exemptions would greatly exceed the limited benefits from dual registration. Based upon conversations with the National Futures Association, MFA understands that there have been almost 4,500 exemptions filed under section 4.13(a)(3) and over 20,000 exemptions filed under section 4.13(a)(4). Rescission of the Private Pool Exemptions would likely increase significantly the number of registrants and further strain the Commission's resources to oversee registrants effectively and monitor markets. In light of the uncertainty over Congressional funding and the Commission's concern with limited resources,[25] we believe the Commission should extend section 4.13(a)(4) to registered advisers (or their commonly controlled affiliates) that advise commodity pools with only highly sophisticated investors and section 4.13(a)(3) to registered advisers that are not engaged primarily in trading commodity interests; and focus its resources in other areas to best protect the public, such as oversight of swaps regulation.

C. The Commission will still Receive Information it needs from the SEC and the Exchanges even if the Private Pool Exemptions are Retained

We acknowledge that registration with an agency has the potential of providing many public benefits. However, we believe dual registration can be redundant and excessively burdensome for registrants; and that regulators have alternative tools to assist with effective industry oversight. We believe it is not necessary for the Commission to repeal the Private Pool Exemptions for investment advisers registered with the SEC to have effective regulatory oversight of an adviser's pool that is currently exempt under the Private Pool Exemptions. The Commissions have proposed new rules and new Form PF under the Commodity Exchange Act ("CEA") and the Advisers Act to collect extensive information from advisers of private funds with respect to the size, strategies and positions of large private funds.[26] The Dodd-Frank Act requires the SEC to share such information with the Commission.[27] As such, the Commission will have access to information on registered advisers trading commodity interests through Form PF and will be able to use information obtained through Form PF to assist with its regulatory programs. This information should address the Commission's concern over any feared lack of accountability with respect to private pools advised by a registered adviser.

Further, as the Dodd-Frank Act mandates the reporting and recordkeeping of both cleared and uncleared swaps,[28] the Commission will have detailed transaction-level information on swaps as well as

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[25] *See* Testimony of Chairman Gary Gensler Before the U.S. Senate Committee on Agriculture, Nutrition & Forestry, March 3, 2011, *available at:* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-72.html; *and* Opening Statement of Commission Michael V. Dunn, Public Meeting on Proposed Rules under Dodd Frank Act, February 24, 2011, *available at:* http://www.cftc.gov/PressRoom/SpeechesTestimony/dunnstatement022411.html.

[26] 76 FR 8068, 8069 (February 11, 2011).

[27] Section 404 of the Dodd-Frank Act.

[28] *See* Section 729 of the Dodd-Frank Act, Reporting and Recordkeeping.

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futures. The Commission will also have information on systemically important entities trading swaps as such entities will have to register with the Commission as "major swap participants";[29] and it will receive regular reports from large swap traders.[30]

D. The Registrations Required by the Removal of the Private Pool Exemption are Costly for Managers

Registration as a CPO and the corresponding compliance requirements represents a significant undertaking in terms of financial expense and the number of employee-hours needed for compliance, even if an entity is already registered in another capacity. CPO registration has its own set of required forms, documents and compliance standards, including fingerprinting and proficiency requirements for CPO principals and employees; and is not synonymous with adviser registration. Firms that are dually registered with the SEC and CFTC often find that separate compliance manuals are necessary in order to comply with inconsistent regulatory requirements with respect to policies and procedures.

The compliance and regulatory requirements are burdensome and costly for private businesses and take time away from their primary focus of managing investor assets. Finally, firms will undoubtedly need to hire new regulatory counsel and/or consultants to assist them with registration and compliance matters. For registered entities, taking on a new registration requirement could double legal and compliance expenses with little additional benefit.

E. The Registrations Required by the Removal of the Private Pool Exemptions Handicap U.S. Managers with Respect to Foreign Rivals, who May Have Less Burdensome Obligations

We are concerned that rescission of the Private Pool Exemptions would handicap U.S. managers with respect to costs associated with meeting regulatory burdens. As markets have become more global, so has competition for investment business. The U.S. financial industry continues to be an important source for jobs and economic growth for this country. Investors invest through on- and off-shore entities, and it would be just as easy for foreign sovereign and U.S. tax-exempt investors to subscribe to non-U.S. managed funds with a more cost-efficient and streamlined regulatory process. In other jurisdictions, such as the U.K., Hong Kong and Singapore, fund managers have a single registration regime, which simplifies registration and compliance and greatly reduces the time and costs associated with compliance. Again, MFA has been and is supportive of ***a*** registration regime for fund managers, but we do not believe duplicative regulation, along with doubling the costs of compliance, will protect investors any better or be the most efficient use of taxpayer funds.

Rescission of the Private Pool Exemptions would require registered advisers in the U.S. to expend proportionately greater time and money on compliance than their foreign competitors, putting them at a competitive disadvantage as less money is dedicated to reinvestment in the business. As noted, registration and compliance is burdensome and costly for registrants and investors, and in the aforementioned scenarios, of little added benefit to investors.

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[29] Section 731 of the Dodd-Frank Act.

[30] Section 730 of the Dodd-Frank Act, Large Swap Trader Reporting.

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II. Conclusion

MFA appreciates the opportunity to provide comments on the Commission's proposal to rescind the Private Pool Exemptions. As discussed, we believe the Commission should preserve and amend the exemption in: (1) section 4.13(a)(4) for an investment adviser who is registered with the SEC (or its commonly controlled affiliate); and (2) section 4.13(a)(3) for an SEC-registered investment adviser (or its commonly controlled affiliates) whose underlying fund does not engage primarily in trading commodity interests. We believe these limited exemptions from CPO registration are consistent with the objectives of the Dodd-Frank Act, allow the Commission to have access to pertinent information relating to a commodity pool, and reduce unnecessary duplicative regulation, and the time and cost burdens associated with compliance for managers and investors.

We would be happy to discuss our comments or any other issues raised in the Release at greater length with the Commission or its staff. If staff has any questions, please do not hesitate to call Jennifer Han or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

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

Cc:

The Hon. Chairman Gary Gensler
The Hon. Commissioner Michael Dunn
The Hon. Commissioner Bart Chilton
The Hon. Commissioner Jill Sommers
The Hon. Commissioner Scott O'Malia
Ananda Radhakrishnan, Director
Division of Clearing and Intermediary Oversight