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Higher Cost and Fewer Choices: Rule 4.5's Impact on Investors

The decision by the Commodity Futures Trading Commission to impose a second layer of redundant regulation on advisers to registered investment companies like mutual funds and exchange traded funds (ETFs) means investors will likely pay a significant price in higher costs and fewer choices.

Costs

Mutual funds and ETFs are the most highly-regulated investment products in the country and are already governed by all four of the major federal securities laws. The broad scope of Rule 4.5 would result in many fund advisers being required to register with the CFTC, subjecting them to another layer of regulation on top of existing robust regulation by the Securities and Exchange Commission. Investors will face higher costs due to the imposition of new CFTC requirements.

- **Higher fees and costs for investors**

  Imposing an additional layer of CFTC regulation on top of existing stringent SEC regulation of funds and their advisers means shareholders will have to pay higher fees to cover increased legal and regulatory costs for no identified benefit. For example, the new rule will drive higher fees by requiring fund advisers to:

  - Register with the CFTC and join the National Futures Association, the self-regulatory organization for the futures industry
  - Develop additional required disclosures for shareholders
  - Upgrade systems to produce extensive regulatory reports
  - Train salespeople to explain added new disclosures required by the CFTC
  - Hire and train counsel and compliance professionals

  All of these costs will come ultimately out of shareholders' pockets.

- **More expensive portfolio management raises investor expenses**

  Mutual funds use derivatives to efficiently manage their portfolios, which benefits investors by lowering costs. Losing or reducing the ability of funds to use derivatives for these and other valuable purposes could increase trading costs and lower investors' choice. Funds use derivatives for portfolio management in a number of ways, including:

  - Hedging currency or credit risks
  - Fine-tuning portfolios
  - Gaining access to asset classes that are too difficult or costly to trade directly, such as some foreign markets
  - Providing increased asset class diversification for investors

- **Congressional concern about higher costs for investors**
    - In 2011, Representatives Kingston (R-GA), Conaway (R-TX) and Owens (D-NY) wrote to the CFTC about their concerns that the CFTC rule "will likely result in higher costs for many of our constituents that have invested their savings in investment plans that have exposure to futures market."

Fewer Choices/Consolidation

- The broad reach of the CFTC's rule will result in hundreds of funds being subject to the CFTC's regulatory requirements, which will likely drive some firms to stop offering funds that use derivatives—resulting in fewer choices for investors.