INVESTMENT COMPANY INSTITUTE

1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

December 21, 2012

VIA ELECTRONIC MAIL

Gary Barnett
Director
Division of Swap Dealer and Intermediary Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: CFTC Regulation 4.20(c)

Dear Mr. Barnett:

The Investment Company Institute ("ICI")[1] seeks confirmation on behalf of its members[2] that transactions and arrangements permitted by exemptive orders and no-action letters issued by the Securities and Exchange Commission and its staff under Section 17 of the Investment Company Act of 1940 ("Investment Company Act") will be deemed not to implicate CFTC Regulation 4.20(c), which prohibits commingling by a CPO of the property of any pool it operates with the property of any other person.[3]

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[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $13.8 trillion and serve over 90 million shareholders.

[2] As a result of the Commodity Futures Trading Commission's ("CFTC") recent amendments to Regulation 4.5, many registered investment advisers that advise registered investment companies must register as commodity pool operators ("CPOs"). Although ICI has judicially challenged amended Regulation 4.5, see Complaint, Investment Company Institute, et al. v. CFTC, Case No. 1:12-cv-00612 (D.D.C. Apr. 17, 2012), it is committed to assisting its members' efforts to comply with the amended regulation.

[3] We are requesting similar relief from the National Futures Association with respect to its Compliance Rule 2-45, which prohibits loans by a commodity pool to a CPO or other affiliated person or entity.

Section 17 and other provisions of the Investment Company Act also prohibit these arrangements, based on the same principles underlying Regulation 4.20(c). Pursuant to exemptive relief and/or no-action letters issued by the Securities and Exchange Commission ("SEC") and its staff, however, registered investment companies ("funds") are permitted to engage in certain transactions and arrangements that could potentially implicate Regulation 4.20(c), subject to specific conditions that are designed to address the concerns shared by the SEC and CFTC. Because the conditions imposed on such arrangements by the SEC and its staff address the shared concerns of both regulators, we request that you confirm that the CFTC would deem arrangements permitted by these SEC exemptive orders and no-action letters not to implicate Regulation 4.20(c). Our analysis is discussed in more detail below.

<u>The Concerns Underlying Section 17 and other Investment Company Act Provisions and Regulation 4.20(c) are Substantially Similar</u>

Section 17, along with other provisions of the Investment Company Act that restrict transactions and other arrangements between funds and their affiliates, is intended to prevent self-dealing and other forms of overreaching of a fund by its affiliates. For example, Section 17(a) of the Investment Company Act generally prohibits an affiliated person, or an affiliated person of an affiliated person, of a fund (a "second-tier affiliate"), acting as principal, from knowingly purchasing from the fund any security or other property. This section protects investors by prohibiting a purchase or sale transaction when a party to the transaction has both the ability and the pecuniary incentive to influence the actions of the fund. Section 17(d) of the Investment Company Act and Rule 17d-1 thereunder generally prohibit an affiliated person or second-tier affiliate of a fund, acting as principal, from participating in any joint enterprise, joint arrangement, or profit-sharing plan, as defined in the rule, without first obtaining an order from the SEC. These provisions are intended to protect investment companies from participating in transactions or arrangements with affiliated persons on inequitable terms. Section 17(f) of the Investment Company Act governs the custody of a fund's assets, including its portfolio securities. It requires a fund to maintain its securities and other investments with certain types of custodians (*e.g.,* banks and members of national securities exchanges) under conditions designed to assure the safety of the fund's assets.

Likewise, Regulation 4.20(c) was adopted to protect pool participants from abuses of their funds at the hands of the CPO.[4] Thus, the concerns that Section 17 is intended to address are substantially similar to those underlying Regulation 4.20(c).

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[4] Regulation 4.20(c) provides that "[n]o commodity pool operator may commingle the property of any pool that it operates or that it intends to operate with the property of any other person." As explained in the CFTC's proposing release on the predecessor to Regulation 4.20(c), "[t]he Commission, through investigations and enforcement proceedings, is aware of several instances in which the operation of a pool in a CPO's name and the commingling of pool property have resulted in abuses of customers' funds." *Revisions of Commodity Pool Operator and Commodity Trading Advisor Regulations; Proposed Rules,* 45 Fed. Reg. 51600, 51604, Aug. 4, 1980.

The SEC Staff Has Provided Relief for Certain Transactions and Arrangements by Funds Otherwise Prohibited by Section 17

Like other regulators, the SEC has rigorous processes in place for offering relief from the rules it promulgates and enforces, in the form of exemptive orders and no-action letters. Section 6(c) of the Investment Company Act grants the SEC the authority to provide exemptions from any provision of the Act or from rules or regulations thereunder if "such exemption is necessary or appropriate in the public interest and consistent with the protection of investors…." Before granting exemptive orders, the SEC publishes a notice to the public regarding the proposed order and provides an opportunity for public comment. No-action letters, while provided by the SEC staff rather than the Commission and not subject to public comment, involve a similar legal analysis. Specifically, they analyze the particular facts and circumstances involved, discuss applicable laws and rules, and conclude that the SEC staff would not recommend that the Commission take enforcement action against the requester based on the facts and representations provided. Both exemptive orders and no-action letters typically include conditions to which the applicant has agreed that are designed to address the concerns underlying the laws or rules from which relief is being provided.

Through these processes, the SEC (or its staff) has carefully considered and determined to permit a number of arrangements that might otherwise violate Section 17 of the Investment Company Act, on the grounds that under specified conditions such arrangements do not raise the concerns underlying that section, and are in the public interest and consistent with the protection of investors.

For example, notwithstanding the general prohibition on joint transactions, the SEC has granted permission in the form of both exemptive orders and no-action relief for certain types of joint accounts, subject to a number of conditions. These include more than 50 exemptive orders permitting fund families to make short-term investments through joint accounts, such as for uninvested cash balances remaining at the end of the day and cash collateral.[5] Such joint arrangements provide the benefits of saving transaction and other fees, providing better pricing, and offering greater flexibility than any individual fund could obtain on its own.[6]

The orders permitting joint accounts, for example, impose a series of conditions designed to address the underlying purposes of Section 17(d) and Rule 17d-1 to "ensure fair dealing and no overreaching in connection with joint transactions involving an investment company and its affiliated per-

[5] *See, e.g., The Chase Manhattan Bank,* SEC No-Action Letter under Investment Company Act – Sec. 17(d), July 24, 2001, available at http://www.sec.gov/divisions/investment/noaction/chase072401.htm (describing a number of these orders, and granting no-action relief to other funds that engage in similar transactions conducted in accordance with the conditions that were imposed by the SEC in such orders).

[6] *See, e.g., In the Matter of Fidelity Fund, Inc., et al.,* Investment Company Act Release Nos. 11962 (notice) (Sept. 29, 1981) and 12061 (order) (Nov. 27, 1981).

sons."[7] These conditions include, for example: (1) joint accounts are subject to the participants' custody agreements; (2) in order to prevent any participant from using funds credited to another participant, no participant will be allowed to create a negative balance; (3) the board of trustees or directors of each fund will adopt procedures that are reasonably designed to provide that the conditions are met, and will determine at least annually that the accounts have been operated in accordance with the procedures; (4) each participant will participate in a joint account on the same basis as any other participant; and (5) each participant's investment in a joint account will be documented daily on its books and on the books of its custodian.[8] While other exemptive orders and no-action letters may contain different conditions, they would similarly be designed to address the concerns against which Section 17(d) and Rule 17d-1 were meant to protect. Any such conditions would supplement requirements that funds maintain books and records regarding their assets and that funds undergo an annual audit of their financial statements, which involves confirming assets held in custody accounts. Moreover, when the SEC staff conducts an examination of a fund or fund family, it will typically assess compliance with the conditions or representations in exemptive applications or no-action letters relied on by the fund.

We believe these and other conditions to relief from Section 17 address the concerns underlying CFTC Regulation 4.20(c). We therefore request confirmation that funds engaging in arrangements pursuant to exemptive orders or no-action letters provided by the SEC and its staff will be deemed not to implicate Regulation 4.20(c).

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[7] *Id.*

[8] *See id.*

We sincerely appreciate the willingness of CFTC staff to address the industry's concerns. If you have questions or require further information, please contact me at 202/326-5815, Sarah A. Bessin at 202/326-5835 or Mara L. Shreck at 202/326-5923.

Sincerely,

/s/ Karrie McMillan

Karrie McMillan
General Counsel

CC: Amanda Olear, Special Counsel
Michael Ehrstein, Attorney-Advisor

Division of Swap Dealer and Intermediary Oversight
Commodity Futures Trading Commission
Daniel A. Driscoll, Executive Vice President, Chief Operating Officer
Thomas W. Sexton, III, Senior Vice President, General Counsel and Secretary

National Futures Association

Norm Champ, Director
Jennifer McHugh, Senior Advisor to the Director
Brian P. Murphy, Senior Counsel to the Director
Doug Scheidt, Chief Counsel

Division of Investment Management
Securities and Exchange Commission