INVESTMENT COMPANY INSTITUTE

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September 28, 2017

Mr. Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Project KISS (RIN 3038-AE55)

Dear Mr. Kirkpatrick:

The Investment Company Institute[1] commends the Commodity Futures Trading Commission for undertaking its "Project Kiss" initiative to determine how the Commission's rules, regulations, or practices can be applied in a simpler, less burdensome manner.[2] ICI and its members have a strong interest in the CFTC and its staff rationalizing CFTC rules to reduce unnecessary burdens on market participants, particularly by recognizing the critical differences between registered investment companies ("registered funds") and traditional participants in the commodity markets. As participants in the derivatives markets, registered funds support regulation designed to maintain orderly, competitive, and efficient derivatives markets. Derivatives are a particularly useful portfolio management tool in that they offer registered funds considerable flexibility in structuring their investment portfolios.[3]

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[1] ICI is a leading global association of regulated funds, including mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$20.4 trillion in the United States, serving more than 95 million US shareholders, and US$6.7 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

[2] *Project Kiss*, 82 Fed.Reg. 23765 (May 24, 2016), *available at* http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2017-10622a.pdf.

[3] A registered fund uses derivatives, among other things, to hedge positions, equitize cash, adjust the duration of its portfolio, and generally manage the portfolio in accordance with the investment objectives stated in its prospectus.

Registered funds are subject to CFTC regulation in two separate capacities. First, funds are buy-side participants in the derivatives market and are subject to rules such as the clearing mandate and the trading obligation. Second, registered funds are subject to CFTC regulation as a result of the CFTC's 2012 amendments to Regulation 4.5 under the Commodity Exchange Act (CEA), which required many registered fund advisers to register with the CFTC as commodity pool operators (CPOs).

We welcome this opportunity to provide our recommendations as the Commission reconsiders the application of its rules. We believe our recommendations are consistent with the agenda Chairman Giancarlo recently articulated for the CFTC,[4] particularly his goals of:

- Reducing regulatory burden, consistent with President Trump's executive orders;[5]
- Returning the CFTC to "regular order," and
- Resetting the CFTC's focus on its core mission, including leveraging its cooperation with parallel federal market regulators such as the Securities and Exchange Commission.

We recognize that some of our recommendations may, or would, require the Commission to engage in rulemaking. We discuss those issues in our letter, however, because we believe they are critical issues for the Commission's further consideration, and hope this discussion will be the beginning of a further and more in-depth dialogue.

We have organized our recommendations, below, according to each of the topics on which the Commission seeks comment.[6] For your convenience, our attached recommendations are summarized briefly below:

- **The CFTC should amend Regulation 4.5 to eliminate unnecessary regulatory overlap for registered funds and their advisers.** The CFTC should amend the rule to exclude registered funds advisers from being treated as CPOs, just as they were immediately prior to the rule's 2012

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

[5] *See* Exec. Order, Reducing Regulation and Controlling Regulatory Costs (Jan. 30, 2017), *available at* https://www.whitehouse.gov/the-press-office/2017/01/30/presidential-executive-order-reducing-regulation-and-controlling; *see also* Exec. Order, Enforcing the Regulatory Reform Agenda (Feb. 24, 2017), *available at* https://www.whitehouse.gov/the-press-office/2017/02/24/presidential-executive-order-enforcing-regulatory-reform-agenda.

[6] Consistent with the electronic filing requirements, we are filing this cover letter, along with an Appendix that corresponds to the topic of the respective Commission filing portal (registration, reporting, clearing, executing). *See* https://comments.cftc.gov/KISS/KissInitiative.aspx.

amendments.

- **Until the CFTC amends Regulation 4.5, it should take a substituted compliance approach to regulating registered fund CPOs and CTAs.** We suggest that the CFTC and its staff take a pragmatic, outcomes-based substituted compliance approach to addressing regulatory overlap for registered fund CPOs and CTAs in areas that were not adequately addressed by harmonization, and take such an approach as new issues arise in the future. We provide, as examples, Forms CPO-PQR and CTA-PR, liquidation statements, and recordkeeping.

- **The CFTC should adopt its rulemaking proposal that would provide relief to CPOs and CTAs acting on behalf of non-US persons.** We urge the CFTC promptly to adopt its 2016 rulemaking proposal that would, among other things, amend Regulation 3.10(c)(3) to eliminate unnecessary conditions, consistent with prior staff no-action relief.

- **The CFTC should amend its definition of "US person" to exclude certain non-US funds**. For purposes of the cross-border application of the CFTC's swaps provision, the CFTC should exclude from its definitions of "US person" non-US regulated funds that are authorized to be publicly offered to non-US persons but are not offered publicly to US persons.

- **The CFTC should retain the strong asset protections for cleared swaps provided by the "LSOC" model.** As the CFTC considers any recommendations for reform it may receive in the clearing area, we urge it to retain the "legal segregation with operational commingling," or LSOC, model for the protection of customer collateral and extend these protections to other cleared derivatives.

- **The CFTC should strengthen the process for making a swap "available to trade."** The CFTC should engage in a rulemaking that would address the risks and weaknesses inherent in the current "made available to trade," or MAT, process. We recommend that this process ensure that only those swaps that are liquid enough to support mandatory execution on a swap execution facility or designated contract market become MAT.

We also share Chairman Giancarlo's interest in reforming the CFTC's swap trading rules to foster a vibrant and liquid swaps market. To that end, we are preparing a separate letter—that we expect to submit soon—which will contain a set of recommendations designed to improve swaps trading.

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We appreciate the Commission's consideration of our recommendations. If you have questions or require further information, please contact me at (202) 218-3563, Sarah Bessin at (202) 326-5835, Jennifer Choi at (202) 326-5876, or Rachel Graham at (202) 326-5819.

Sincerely,

/s/ Dorothy M. Donohue

Dorothy M. Donohue
Acting General Counsel

cc: The Honorable J. Christopher Giancarlo
The Honorable Brian D. Quintenz
The Honorable Rostin Benham

Matthew B. Kulkin, Director
Division of Swap Dealer and Intermediary Oversight
Commodity Futures Trading Commission

Thomas W. Sexton, III, President and CEO
Regina G. Thoele, Senior Vice President, Compliance
National Futures Association

Appendix: Reporting Recommendations

Reporting Recommendation: Until the CFTC Amends Regulation 4.5, It Should Take a Substituted Compliance Approach to Regulating Registered Fund CPOs and CTAs

Background: In August 2013, approximately eighteen months after the CFTC adopted the Regulation 4.5 amendments, the CFTC finalized a related rulemaking to "harmonize" its requirements with those of the SEC.[1] The final harmonization rulemaking acknowledged the robustness of the SEC regulatory regime for registered funds. On this basis, the final rule takes a "substituted compliance" approach — that is, it exempts registered fund advisers subject to the CFTC's jurisdiction from certain CFTC regulations on the basis that adherence to the SEC's rules generally "should provide market participants and the public with meaningful disclosure … provide the [CFTC] with information necessary to its oversight … and ensure that [registered fund advisers] maintain appropriate records regarding their operations."[2] Regrettably, however, the CFTC's harmonization rulemaking did not provide relief with respect to several key substantive areas in which registered fund CPOs remain subject to costly, duplicative regulation. Nor did it provide any relief for registered fund CTAs, which may serve as subadvisers to registered funds that are subject to CFTC regulation.[3] It also left registered fund CPOs and CTAs subject to the compliance rules of the NFA, in addition to SEC and CFTC rules, resulting in significant regulatory overlap.

Recommendation: Until the CFTC amends Regulation 4.5 as we suggest,[4] we recommend that the Commission and its staff take a pragmatic, outcomes-based substituted compliance approach[5] to addressing regulatory overlap for registered fund CPOs and CTAs in areas that were not adequately

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[1] *See Harmonization of Compliance Obligations for Registered Investment Companies Required To Register as Commodity Pool Operators*, 78 Fed.Reg. 52308 (Aug. 22, 2013) ("Harmonization Adopting Release").

[2] *Id.*

[3] *See Division of Swap Dealer and Intermediary Oversight Responds to Frequently Asked Questions – CPO/CTA: Amendments to Compliance Obligations* (Aug. 14, 2012), which postponed the recordkeeping, reporting, and disclosure compliance obligations for registered fund CTAs until "60 days following the effective date of a final rule implementing the Commission's proposed harmonization effort." Unfortunately, despite the FAQs' suggestion that relief for CTAs might have been forthcoming, the Harmonization Adopting Release did not provide any relief for registered fund CTAs.

[4] Please see our recommendations related to registration, which we filed concurrently with, and which also include, this recommendation.

[5] Chairman Giancarlo has described his recommended approach to international engagement as comity, not uniformity, noting that "[t]he CFTC should move to a flexible, outcomes-based approach for cross-border equivalence and substituted compliance." Acting Chairman J. Christopher Giancarlo, *CFTC: A New Direction Forward, Remarks before the 42nd Annual International Futures Industry Conference,* Boca Raton, Florida (March 15, 2017), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-20 ("A New Direction Forward"). Similarly, in utilizing a substituted compliance approach in regulating registered fund CPOs and CTAs, the CFTC's goal should not be uniformity, but comparable regulatory outcomes.

addressed by harmonization, and take such an approach as new issues arise in the future.[6] A substituted compliance approach to the regulation of registered fund CPOs and CTAs is consistent with the CFTC's acknowledgement in its 2013 harmonization rulemaking of the robustness of the SEC regulatory regime for registered funds.[7] Permitting registered fund CPOs and CTAs to satisfy their CFTC and NFA obligations through substituted compliance would eliminate the duplicative regulation to which these entities currently are subject, and thereby would lower some of the costs and regulatory burdens amended Regulation 4.5 has imposed on registered funds and their shareholders. This approach would further Chairman Giancarlo's goals of reducing excessive regulatory burdens, increasing the Commission's ability to focus on its core mission, and leveraging existing regulation by other regulators, such as the SEC.[8] Substituted compliance would accomplish these objectives with no loss of protection for investors and the markets.[9]

It is critical that registered fund CTAs also receive substituted compliance relief. The SEC's rules under the Investment Company Act of 1940 and the Investment Advisers Act of 1940 do not distinguish between registered fund advisers and sub-advisers — they are each treated as an "adviser" and subject to registration and regulation under the Advisers Act. Thus, not providing relief for registered fund CTAs as we request will undercut the benefit of substituted compliance for registered funds.[10]

We note that the CFTC's undertaking a more comprehensive substituted compliance approach to the regulation of registered fund CPOs and CTAs should only be viewed as a temporary solution to this issue, and that amending Regulation 4.5, as we recommend above, is the appropriate long-term solution. First, while a substituted compliance approach has many advantages, it does not address the fundamental lack of justification for the CFTC's regulation of registered fund CPOs and CTAs. Even

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[6] As appropriate, this may include CFTC rulemaking, written CFTC or staff guidance or "frequently asked questions." We urge the CFTC and its staff, before issuing guidance or FAQs to provide an opportunity for formal or informal public comment, to ensure that any guidance or FAQs will be workable. In addition, any guidance or FAQs should be publicly available in writing to ensure consistency.

[7] Harmonization Adopting Release, *supra* note 1, at 52310.

[8] A New Direction Forward, *supra* note 5.

[9] For similar reasons, we recommend that the CFTC direct the NFA to take a substituted compliance approach with respect to the regulation of registered fund CPOs and CTAs. Although NFA has taken a substituted compliance approach to regulating registered fund CPOs in certain areas, registered fund CPOs and CTAs largely are still subject to regulation by NFA in areas that overlap with their regulation by the SEC, including regulatory reporting, recordkeeping, and other regulatory requirements.

[10] Advisers and subadvisers to controlled foreign corporations (CFCs) similarly should receive substantive compliance relief. A CFC typically is established as a wholly-owned subsidiary of a registered fund. The SEC staff requires registered funds employing a subsidiary structure to operate the subsidiary in conformity with the key substantive provisions of the Investment Company Act, notably Section 8 (investment policies), Section 17 (affiliated transactions and custody requirements) and Section 18 (capital structure and leverage). Without substituted compliance for the operators of and advisers to CFCs, much of the benefit of substituted compliance will be lost.

a substituted compliance approach still imposes considerable costs both on registered fund CPOs and CTAs, as well as the CFTC and NFA and their staffs, which still must devote a considerable amount of their limited resources to achieving substituted compliance, at the expense of their core mission. Second, registered fund advisers that are able to rely on amended Regulation 4.5, and are not required to register as CPOs, must nonetheless monitor their portfolio composition, trading, and marketing activities on an ongoing basis to ensure compliance with the amended rule, which is unnecessarily burdensome and costly.

Specific examples of areas in which a substituted compliance approach should be applied include, but are not limited to, periodic reporting to regulators on Forms CPO-PQR and CTA-PR, pool liquidation statements, and recordkeeping. Harmonization did not adequately address any of these areas.

Periodic Reporting to Regulators

Registered funds are subject to comprehensive reporting requirements under SEC rules. For example, funds are required to report extensive information about their portfolio holdings to the SEC, as well as information about the fund's investment policies and practices, fees and expenses, and other matters.[11] The SEC recently enhanced these reporting obligations to require funds to report additional information on Forms N-PORT and N-CEN, including detailed information about derivatives holdings, fund investment practices, portfolio characteristics, and risk metrics.[12] Registered investment advisers are required to report detailed information about their businesses to the SEC on Form ADV, including information about the funds they manage and, pursuant to a recent rulemaking, data regarding any separately managed accounts.[13] Together, these SEC reporting requirements provide a holistic picture of the adviser and its investment activities.

Much of the information that the SEC requires registered funds and their advisers to report on these forms overlaps with information the CFTC requires on Forms CPO-PQR and CTA-PR. For example, both SEC and CFTC rules require registered funds to report detailed information about fund portfolio holdings, portfolio characteristics, and risk metrics. Both SEC and CFTC rules require registered advisers to report information about the funds and accounts they manage, including data about fund and account holdings. While in some instances, the SEC and CFTC require slightly different information, both rule sets are intended to accomplish similar regulatory objectives. In the absence of

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[11] *See* SEC Forms N-CSR, N-Q, and N-SAR.

[12] *See Investment Company Reporting Modernization*, 81 Fed.Reg. 81870 (Nov. 18, 2016) ("Investment Company Reporting Adopting Release"). Form N-CEN replaced and updated existing SEC Form N-SAR. Form N-PORT replaced Form N-Q, and will require monthly reporting of a fund's portfolio holdings data.

[13] *See Form ADV and Investment Advisers Act Rules*, 81 Fed.Reg. 60418 (Sept. 1, 2016) ("ADV Adopting Release"). The enhanced reporting requirements the SEC adopted in the ADV Adopting Release and the Investment Company Reporting Adopting Release are subject to phased in compliance dates beginning October 2017 for the Form ADV amendments and June 2018 for the enhanced fund reporting requirements.

substituted compliance, registered fund sponsors must develop systems to source, compile and report multiple sets of very similar information to comply with these rules and report similar, but sometimes slightly different, information for the same entity. This is costly, burdensome, unnecessary, and inefficient.

We therefore recommend that the CFTC permit registered fund CPOs and CTAs to satisfy their obligation to file Form CPO-PQR and CTA-PR by filing SEC Forms N-PORT, N-CEN, and Form ADV.[14] A substituted compliance approach to reporting would provide the CFTC with comparable data about registered funds and their advisers, without imposing undue burdens and costs on registered funds and their shareholders.

Pool Liquidations

CFTC Regulation 4.22(c) addresses the annual report requirements applicable to registered CPOs ("Annual Report"). The rule provides that, if a pool ceases trading, the CPO may, in lieu of the full Annual Report, provide a "liquidation statement" to the NFA and pool participants that includes audited financial statements, unless the CPO obtains waivers from pool participants.

When the CFTC issued the harmonization rulemaking in 2013, it provided in the adopting release that a registered fund CPO could satisfy its obligation to file an Annual Report by filing with NFA the financial statements the fund files with the SEC.[15] The harmonization rulemaking, however, did not explicitly address how a registered fund CPO should comply with the "liquidation statement" requirement under Regulation 4.22(c). The CFTC staff subsequently took the view that registered fund CPOs are subject to the liquidation statement requirement with respect to each series of a registered fund that is liquidating.[16]

Registered funds already are subject to SEC requirements and safeguards that address the same concerns as the CFTC's liquidation statement requirement, but better reflect the structure of registered funds and the nature of their operations. For example, the SEC requires funds: (1) to be governed by a board

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[14] We note that registered fund CPOs also are required to file NFA Forms PQR and PR. We recommend that the CFTC direct the NFA to take a substituted compliance approach with respect to the regulation of registered fund CPOs and CTAs, including with respect to regulatory reporting. *See supra* note 9.

[15] "The final rule requires that operators of RICs file annual financial statements with the NFA, pursuant to the terms of § 4.22(c), which is applicable to all CPOs. It permits operators of RICs to file the same financial statements that it [sic] prepares for its compliance obligations with the SEC." Harmonization Adopting Release, *supra* note 1, at 52325.

[16] Many registered investment companies are organized as a single corporation or trust that has multiple "series," each of which represents an interest in a separate pool of securities with separate and segregated assets, liabilities, and shareholders. The CFTC staff has stated that when the corporation or trust (rather than the series) that is registered as an investment company liquidates, the CFTC will accept, as substituted compliance with the liquidation statement requirement, the registered fund's filing with the SEC of SEC Form N-8F, which provides details regarding the liquidation. *See* CFTC Letter 17-04 (Jan. 26, 2017), *available at* http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/17-04.pdf.

of directors that typically consists of a majority of independent directors; (2) that offer redeemable securities (e.g., mutual funds) to publish their net asset value on a daily basis; (3) to file and send their shareholders annual audited financial statements, as well as semi-annual financial statements and quarterly statements of portfolio holdings; (4) to report information regarding funds that have liquidated on SEC Form N-CEN, as well as report on a monthly basis certain information reflecting liquidations on SEC Form N-PORT. These requirements all serve to safeguard registered fund shareholders in the event of a fund liquidation and ensure that the SEC and fund shareholders have sufficient information regarding the liquidation and the value of remaining assets in the portfolio.

Although the CFTC staff issued an exemption earlier this year that provides relief to registered fund CPOs with respect to the rule's audit requirement,[17] it is of limited value to registered fund CPOs because they still must undergo the unnecessary burden and expense of preparing financial statements for a liquidating fund, costs which are deducted from remaining fund assets that otherwise would be paid to shareholders. We therefore urge the CFTC to apply a substituted compliance approach and permit registered fund CPOs to satisfy the liquidation statement requirement of Regulation 4.22(c) by complying with relevant SEC requirements.

Recordkeeping[18]

The CFTC's harmonization rulemaking also did not adequately address regulatory overlap with respect to recordkeeping requirements for registered fund CPOs or CTAs. While the harmonization rulemaking provided limited relief from specified recordkeeping requirements applicable to registered fund CPOs (and no relief for registered fund CTAs),[19] it failed to acknowledge that registered funds and their advisers are subject to extensive recordkeeping obligations under the Investment Company Act and the Advisers Act with respect to the maintenance of a broad range of books and records.[20] The CFTC did not provide substituted compliance relief to registered fund CPOs or CTAs in the harmonization rulemaking either with respect to the content of the records required to be maintained under CFTC regulations, or the manner in which such records must be maintained. As a result, registered fund CPOs and CTAs are subject to overlapping recordkeeping regimes.[21]

The SEC's recordkeeping requirements serve the same purposes as, and in some respects are more extensive than, those set forth in the CFTC recordkeeping rules that apply to CPOs and CTAs.

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[17] *See* CFTC Letter No. 17-04 (Jan. 26, 2017), *available at* http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/17-04.pdf.

[18] We acknowledge that this recommendation may require the Commission to engage in rulemaking to implement.

[19] *See* Harmonization Adopting Release, *supra* note 1, at 52321.

[20] The Investment Company Act does not distinguish between advisers and subadvisers to registered funds. They are subject to equivalent regulation under the Investment Company Act and under the Advisers Act (as they must be registered under both laws to advise a registered fund).

[21] Registered fund CPOs and CTAs also are subject to NFA's recordkeeping regulations.

Imposing two overlapping recordkeeping regimes on registered funds is burdensome and costly to fund shareholders, and provides no discernible benefit.

We therefore urge the CFTC to adopt a substituted compliance approach to recordkeeping for registered fund CPOs and CTAs.[22] We discuss these recommendations in more detail in the comment letter ICI filed with the CFTC[23] in connection with the CFTC's recent rulemaking regarding Regulation 1.31.[24]

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[22] To be sufficiently comprehensive, this relief should extend to registered fund advisers that rely on the CFTC's Regulation 4.5 exclusion, those that rely on an exemption or exclusion from CTA registration, along with third parties that hold required records on behalf of registered fund CPOs and CTAs or any of these other entities.

[23] Letter to Mr. Christopher Kirkpatrick, Secretary, Commodity Futures Trading Commission, from David W. Blass, General Counsel, Investment Company Institute, dated March 20, 2017, *available at* https://www.ici.org/pdf/30649a.pdf.

[24] *Recordkeeping,* 82 Fed.Reg. 24479 (May 30, 2017). Our recommendations, which the Commission declined to accept, were based on a rulemaking petition ICI filed with the Commission in 2014. *See* Petition for Rulemaking to Amend CFTC Regulations 4.12(c)(3), 4.23 and 4.33, by Investment Company Institute, dated March 11, 2014, *available at* https://www.ici.org/pdf/27946.pdf).