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Dechert Comment Letter Regarding the Harmonization of Compliance Obligations for Registered Investment Companies Required to Register as Commodity Pool Operators

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

Re: Harmonization of Compliance Obligations for Registered Investment Companies Required to Register as Commodity Pool Operators

Dear Mr. Stawick:

Dechert LLP ("**Dechert**"), on behalf of itself, The Dreyfus Corporation, Massachusetts Financial Services Company, Pacific Life Fund Advisors LLC, Russell Investments, and a number of other mutual funds[1] and their investment advisers, welcomes the opportunity to comment on the proposed rulemaking of the Commodity Futures Trading Commission ("**CFTC**") regarding the harmonization of regulatory requirements for investment companies registered under the Investment Company Act of 1940, as amended ("**1940 Act**"),[2] whose advisers would be required to register as commodity pool operators ("**CPOs**")[3] and be subject to dual regulation by the CFTC and Securities and Exchange Commission ("**SEC**") as a result of a separate CFTC rulemaking that modifies the exclusionary relief available under CFTC Regulation 4.5 ("**Regulation 4.5**").[4] Dechert has been extensively involved in commenting on the CFTC's Part 4 amendments

[1] For ease of reference, this letter uses the term "**mutual fund**" generally to refer to open-end management investment companies registered under the 1940 Act ("**registered investment companies**"). However, it should be noted that the proposed rules would apply equally to registered closed-end investment companies and exchange-traded funds that have registered as unit investment trusts. This letter notes where proposed amendments would affect open-end management investment companies differently from closed-end investment companies and exchange-traded funds ("**ETF**s"), as applicable.

[2] 15 U.S.C. § 80a-1 *et seq.*

[3] Harmonization of Compliance Obligations for Registered Investment Companies Required to Register as Commodity Pool Operators, 77 Fed. Reg. 11345 (Feb. 24, 2012) ("**Proposing Release**").

[4] Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, 77 Fed. Reg. 11252 (Feb. 24, 2012) ("**Adopting Release**").

throughout the rulemaking process, having authored and consulted with our clients on several comment letters to the CFTC.[5]

This comment letter objects broadly to the CFTC's harmonization efforts as wholly deficient. This comment letter goes further to recommend that the CFTC defer to the SEC's long-standing, effective regulatory and disclosure regimes on such matters. This comment letter also addresses the CFTC's cost-benefit analysis of its proposed harmonization, which we believe is insufficient. The CFTC has failed to consider adequately and quantify the costs and benefits to mutual funds and their investors and advisers of the changes to Regulation 4.5 and attendant disclosure, shareholder reporting and recordkeeping requirements in their totality.

As an initial matter, we note that we continue to oppose the amendments to Regulation 4.5 as being overbroad in scope and unnecessary and burdensome in light of the high degree of existing, effective SEC regulation of mutual funds. We also oppose the imposition of additional disclosure, shareholder reporting and recordkeeping requirements on mutual funds and their registered investment advisers who will no longer be able to qualify for the Regulation 4.5 exclusion from CPO registration. Such additional disclosures, shareholder reporting and recordkeeping requirements are substantively duplicative, burdensome and confusing, while adding little in the way of protection to investors. The CFTC has not justified why the application of commodity pool disclosure, shareholder reporting and recordkeeping requirements are necessary, appropriate and preferred over the requirements already applicable to mutual funds. As we have stated, we strongly encourage the CFTC to defer to the SEC on matters of disclosure, shareholder reporting and recordkeeping. Mutual fund operations are complex, and have arguably become more so since the CFTC liberalized Regulation 4.5 in 2003.[6] To simply reinstate (or reinstate with some modifications) a regulatory regime that was applicable to mutual funds trading commodity interests before 2003 fails to recognize how the industry and regulatory requirements have evolved.

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[5] Over the course of this rulemaking process, Dechert submitted five comment letters to the CFTC and advised on several others, addressing various aspects of the proposals. Letter from M. Holland West, Partner, Dechert LLP, to David A. Stawick, Office of the Secretariat, CFTC (Oct. 18, 2010), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=26313&SearchText=, Letter from George J. Mazin, Partner, Dechert LLP, to David A. Stawick, Office of the Secretariat, CFTC (Apr. 12, 2011), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=42176&SearchText=, Letter from Dechert LLP and Clients, to David A. Stawick, Office of the Secretariat, CFTC (Apr. 12, 2011), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=42183&SearchText= ("**Dechert April 2011 Comment Letter**"), Letter from M. Holland West, Partner, Dechert LLP, to David A. Stawick, Office of the Secretariat, CFTC (July 26, 2011) *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47953&SearchText= ("**Dechert July 2011 Comment Letter**"), Letter from M. Holland West, Partner, Dechert LLP, to David A. Stawick, Office of the Secretariat, CFTC (Apr. 5, 2012). The comment letter Dechert submitted on April 5, 2012 was in response to the CFTC final rulemaking amending its Part 4 regulations.

[6] Additional Registration and Other Regulatory Relief for Commodity Pool Operators and Commodity Trading Advisors; Past Performance Issues, 68 Fed. Reg. 47221 (Aug. 8, 2003) ("**2003 Amendments**").

The SEC disclosure regime has served investors well for decades, and there is no evidence that investors or markets have been disadvantaged or harmed. SEC disclosure is well settled and well studied and provides investors with necessary disclosures in a streamlined format and in "plain English." Requiring mutual funds to supplement their existing disclosure will not assist the CFTC in meeting its stated rationales in adopting amendments to Regulation 4.5, which were to: (i) provide the CFTC with information to address certain sources of risk delineated in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("**Dodd Frank Act**");[7] and (ii) allow the CFTC to implement "enhanced oversight" of the derivatives markets and mutual fund commodity interest trading activities.[8]

The CFTC's approach to "harmonization" will create conflicting, confusing and duplicative disclosure. "Harmony" is not created by simply removing the existing impediments to duplicative disclosure, which is what the CFTC states that it has attempted to do. Rather, harmonization should involve a *collaborative* effort to determine what information is necessary for investors to make an informed investment decision. The CFTC's proposal does not identify any reasons why supplementing mutual fund disclosures with its commodity pool disclosures provides potential and existing investors with better information to make an informed investment decision than the current Forms N-1A and N-2. Rather, it merely facilitates implementation of the CFTC's various regulatory requirements and disregards current, applicable SEC-imposed form and substance requirements. Nor does the CFTC's proposal address potential investor confusion that will surely follow from requiring compliance with two different disclosure regimes in one registration statement. Costs for these proposed disclosure changes will be paid by the mutual funds, and thus be borne by investors for whom the CFTC has not demonstrated a need for enhanced disclosure or additional protection. We encourage the CFTC to be receptive to industry comments regarding its proposals in this area.

The CFTC Should Accept, without Modification, the Documentation that Mutual Funds are Already Required to Produce

The CFTC has not justified why the application of commodity pool disclosure, which serves the same general purpose as mutual fund disclosure, but which requires significantly different presentation, is necessary, appropriate and preferred over the existing disclosure requirements imposed on mutual funds under the federal securities laws. The CFTC has not explained (a) what benefits and protections CFTC disclosure

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7 Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. Law 111-203, 124 Stat. 1376 (2010).

8 Adopting Release, at 11253. The proposing release relating to these amendments stated that the CFTC was reevaluating its regulation of CPOs "in order to ensure that the [CFTC] can adequately oversee the commodities and derivatives markets and assess market risk associated with pooled investment vehicles under its jurisdiction." Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 76 Fed. Reg. 7976, 7977-78 (Feb. 11, 2011).

would offer investors that mutual fund disclosure does not already provide and (b) why disclosure must conform to the CFTC's format in order to convey effectively material information to investors. Rather, the CFTC's approach to harmonization seems to be simply an attempt to remove impediments that prevent disclosure requirements designed for a different product (*i.e.*, public commodity pools) and to tack them on to a mutual fund's existing registration statement.

For decades, the SEC has designed and refined mutual fund disclosure documents to promote comparability among funds. The incorporation of CFTC disclosure items into mutual fund prospectuses will adversely affect comparability across mutual funds. Comparability is important for investors and their financial advisors in constructing a well diversified investment portfolio, particularly in the context of retirement plans in which employees are asked to choose from a menu of mutual funds or from among multiple types of mutual funds offering various asset classes (*e.g.*, equity, fixed income and commodities). Comparability is of such importance to the SEC that it has made mutual funds easily comparable by (i) standardizing the content and placement of certain key disclosures in the summary prospectus,[9] (ii) requiring mutual funds to provide eXtensible Business Reporting Language ("**XBRL**") data[10] and (iii) strictly regulating and standardizing the types of performance data that funds are required and allowed to include in fund prospectuses and shareholder reports.[11] Adopting the CFTC proposals would undermine this successful and carefully considered disclosure regime, because it would add confusing, redundant and excessive data and boilerplate legends that are ill suited for the retail investors who constitute the vast majority of shareholders invested in mutual funds that CFTC regulation might reach.[12]

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9 Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, 74 Fed. Reg. 4546 (Jan. 26, 2009) ("**Summary Prospectus Proposing Release**").

10 XBRL is interactive data that mutual funds file with the SEC that allows investors to immediately access and compare to other mutual funds specific information provided in the summary prospectus. Before the advent of use of XBRL data, investors wishing to compare information, such as returns or fees among mutual funds, had to do so manually. XBRL data is intended to assist investors in investment decision-making and make professional investment advising more efficient and cost effective. In order for XBRL data to be read using special software and be useful to investors, its format must be uniform across mutual funds. Interactive Data for Mutual Fund Risk/Return Summary, 74 Fed. Reg. 7748 (Feb. 19, 2009).

11 Advertising by Investment Companies, 53 Fed. Reg. 3868 (Feb. 10, 1988) (amending Form N-1A to standardize the computation of certain performance data used by investment companies) ("**Form N-1A Performance Data Release**").

12 Plain English Disclosure, 63 Fed. Reg. 6370 (Feb. 6, 1998). For further SEC guidance on "plain English" disclosure, refer to "A Plain English Handbook: How to Create Clear SEC Disclosure Documents" *available at* http://www.sec.gov/pdf/handbook.pdf.

SEC Principles of Disclosure, Studies Performed and Retail Investing Focus

The SEC has carefully and deliberately studied and regulated the mutual fund industry since before the adoption of the 1940 Act.[13] The SEC disclosure regime and principles have been crafted and refined over the years to protect the interests of investors. The SEC has worked to ensure that disclosures are made to investors in a clear and concise fashion and in order of importance, with critical information necessary to make an informed investment decision appearing in the summary prospectus, other important information appearing in the statutory prospectus and additional information investors may want to know appearing in the statement of additional information ("**SAI**").[14]

The SEC has conducted research and commissioned focus groups and studies when it has proposed to amend registration statement requirements.[15] In the course of developing the recently adopted summary prospectus requirements, the SEC found that investors prefer to receive information regarding fund investments in a clear, concise format.[16] The CFTC

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13 Report of the Securities and Exchange Commission on Investment Trusts and Investment Companies (1939).

14 *See, e.g.,*. Division of Investment Management Study of Mutual Funds and Derivative Instruments (Sept. 26, 1994) *available at* http://www.sec.gov/news/studies/deriv.txt; SEC, NASD, NYSE, NASAA, The Joint Regulatory Sales Practice Sweep Report (Nov. 5, 1996) *available at* http://www.sec.gov/news/studies/sweeptoc.htm; Siegel & Gale, LLC, Investor Testing of Target Date Retirement Fund (TDF) Comprehension and Communications (Feb. 15, 2012) (commissioned by the SEC) *available at* http://www.sec.gov/comments/s7-12-10/s71210-58.pdf.

It bears noting that, although the mutual fund registration statement is organized in three parts, the SAI is incorporated by reference into the statutory prospectus and summary prospectus, integrating the three into a single disclosure document which is readily available to investors on mutual fund websites and the SEC's EDGAR system, and otherwise available upon request within three business days. Form N-1A, General Instruction D.1(b); Form N-2, General Instruction F.

15 In 1996, as the SEC considered amending its disclosure rules for mutual funds, it convened focus groups and availed itself of an extensive study which the Investment Company Institute ("**ICI**") commissioned. *See* Proposed New Disclosure Option for Open-End Management Investment Companies, Fed. Reg. 10943 (March 10, 1997), ICI Report to the SEC, The Profile Prospectus: An Assessment by Mutual Fund Shareholders (May 1996).

"The [SEC] engaged a consultant to conduct focus group interviews and a telephone survey concerning investors' views and opinions about various disclosure documents filed by companies, including mutual funds. During this process, investors participating in focus groups were asked questions about a hypothetical Summary Prospectus. Investors participating in the telephone survey were asked questions relating to several disclosure documents, including mutual fund prospectuses." Summary Prospectus Proposing Release, at 4548, n.32.

From 2006-2008, the SEC held a series of roundtables and meetings, (most with an open comment period), to discuss how the internet and interactive data can best be used to improve disclosure. The June, 2006, session featured two panels devoted to disclosure to mutual fund investors and included panelists such as Directors/CIOs of major fund complexes and Morningstar, FINRA and ICI executives, and Barbara Roper, the Director of Investor Protection for the Consumer Federation of America. Roundtable materials may be found at http://www.sec.gov/spotlight/xbrl/xbrl-meetings.shtml.

16 Investment Company Institute, Understanding Investor Preferences for Mutual Fund Information (2006) (cited at Summary Prospectus Proposing Release, at 4547, n.18 for "noting that sixty percent of recent fund

has done nothing similar to assess the practical implications of applying its proposed disclosures—developed for commodity pools engaged in significant commodity interest trading, which are a different investment vehicle—to mutual funds.

Disclosure Content Issues

In order to comply with the CPO "Disclosure Document" content requirements under CFTC Regulations 4.24 and 4.25,[17] the CFTC's proposed approach to harmonization would require a mutual fund whose adviser is subject to dual regulation by the CFTC and SEC to add certain conflicting, confusing, duplicative and burdensome disclosures to its prospectus and SAI. The CFTC stated in the Proposing Release that, "where CFTC requirements differ slightly [from SEC-required disclosures], the Commission believes that CFTC-required disclosures can be presented concomitant with SEC-required information in a registered investment company's prospectus," and that the CFTC is proposing relief to harmonize the "few instances where conflicts in disclosure have been identified."[18] We believe that this statement is not true. The CFTC-required disclosures differ from the SEC-required disclosures materially in form and in substance. There are numerous CFTC disclosure requirements that would create conflicts, significant investor confusion, or duplication with the SEC's disclosure rules or are not material to the operations of most mutual funds, and would be very burdensome to implement. Additionally, the CFTC has not demonstrated that such additional disclosures benefit investors or the industry.

We submit that the comprehensive disclosure requirements under the Securities Act of 1933, as amended ("**1933 Act**"), and the 1940 Act allow investors to understand clearly and evaluate the potential risks and costs of investing in mutual funds that invest in commodity interests and are sufficient to address the concerns of the CFTC. Given the conflicts, duplication and related potential for confusion between general types of CFTC and SEC disclosures, a serious question arises as to whether items from the CPO Disclosure Document would materially augment investor protections or would simply result in mutual fund disclosures that are different, and not necessarily better.[19]

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investors describe mutual fund prospectuses as very or somewhat difficult to understand, and two-thirds say prospectuses contain too much information"). *See, e.g.* NASD Mutual Fund Task Force, Report of the Mutual Fund Task Force: Mutual Fund Distribution (Mar. 2005) (cited at Summary Prospectus Proposing Release, at 4547, n.19) *available at* http://www.finra.org/web/groups/rules_regs/ documents/rules_regs/p013690.pdf; Consumer Federation of America, Mutual Fund Purchase Practices, An Analysis of Survey Results (June 2006) (cited at Summary Prospectus Proposing Release, at 4547, n.20).

17 17 C.F.R. §§ 4.24 and 4.25.

18 Proposing Release, at 11346-47.

19 Examples include disclosing the amount and effect of fees on an investor's returns, and disclosing performance during periods of especially positive and negative returns. In adopting the current Form N-1A prospectus requirements, the SEC noted that fund investors felt "bombarded" with "more information than they can handle and that they can intelligently assimilate" under the prior Form N-1A prospectus

Moreover, much of the cost of additional and different disclosures would be passed on to fund investors, decreasing their investment returns. We do not see, and the CFTC has not identified, any need for additional or different disclosures to protect mutual fund investors.

We request that the CFTC reconsider its proposal to require mutual funds whose advisers will be subject to dual regulation to comply with CPO Disclosure Document requirements. As we previously stated in our other comment letters to the CFTC, we request that the CFTC defer to the disclosure framework under the SEC's rules already applicable to mutual funds as a general matter and in each instance identified herein.

A number of the significant disclosure conflicts and confusing disclosure requirements are highlighted in prior comment letters Dechert submitted to the CFTC ("**Dechert Comment Letters**").[20] We believe that the issues identified in the Dechert Comment Letters remain applicable. Below, we address and respond to the statements and proposals of the CFTC set forth in the Proposing Release and also identify certain important areas of material conflict, confusion or duplication between the SEC disclosure requirements and the CFTC's CPO Disclosure Document requirements that the proposed harmonization would create.

Performance Disclosure. The CFTC noted in the Proposing Release that the SEC's and CFTC's performance disclosure requirements may conflict, and requested comment. We are concerned that the proposed additional required performance disclosure would not "strike the appropriate balance between achieving the [CFTC's] objective of providing material information to pool participants, and reducing duplicative or conflicting disclosure."[21] We also believe that many of the CFTC's requirements are not consistent with the CFTC's statement in the Adopting Release for the amendments to Regulation 4.5 that "it is not the Commission's intention to burden registered investment companies beyond what is required to provide the Commission with adequate information it finds necessary to effectively oversee the [mutual fund's] derivatives trading activities."[22]

- *Performance—Other Pool Performance Disclosure:* For commodity pools that have not operated for at least three years, a CPO Disclosure Document must provide performance information for *each other pool and account* the fund's CPO operates. In addition, a CPO must provide the same information for certain of the

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requirements. *See* Summary Prospectus Adopting Release, at 4547, n.18 (quoting Don Phillips, Managing Director, Morningstar, Transcript of U.S. Securities and Exchange Commission Interactive Data Roundtable, at 26) (June 12, 2006)).

20 *See* Dechert July 2011 Comment Letter and Dechert April 2011 Comment Letter.

21 Proposing Release, at 11348.

22 Adopting Release, at 11255.

CPO's trading principals, "major commodity trading advisors" ("**CTAs**"), "major investee pools" and other CTAs and investee pools ("**Other Performance Information**").[23]

A mutual fund is generally prohibited from disclosing the performance of other pools/funds and accounts managed by its investment advisers in its prospectus.[24] In limited circumstances, the SEC staff has provided relief under the 1940 Act to permit a mutual fund to include disclosure of relevant Other Performance Information in its prospectus or SAI, but *only if* the other funds or accounts are *similar enough to the mutual fund to be relevant to an investor*. This is subject to the mutual fund complying with various conditions designed to ensure that the Other Performance Information is not presented as a substitute for the mutual fund's performance.[25] If Other Performance Information does not satisfy these limited conditions, the SEC considers the disclosure to be misleading to investors.

Absent relief from the SEC, requiring the Other Performance Information in a mutual fund prospectus would be in direct conflict with the SEC positions discussed above. The CFTC noted in the Proposing Release that mutual funds could request no-action relief from the SEC's staff to include this additional performance information in their registration statements.[26] The CFTC's suggestion that SEC no-action relief could address certain inconsistencies between the CFTC and SEC disclosure rules[27] is not a legitimate component of a harmonization proposal, and moreover is not an appropriate regulatory solution. Additionally, requiring further action by industry participants increases drafting and negotiation time and costs, further to the detriment of investors. Even pursuing that course, no-action relief under the 1940 Act reflects the views of the SEC's Division of Investment Management on enforcement action only. Such relief is not binding on the SEC itself, the staff of other divisions of the SEC or private litigants.

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23 17 C.F.R. §§ 4.25(c)(2)-(5) and (a)(3). While we appreciate that the CFTC has proposed to allow a mutual fund to include any necessary Other Performance Information in its SAI, we note that larger fund sponsors may potentially need to include voluminous Other Performance Information to satisfy this requirement.

24 *See, e.g.*, *Nicholas-Applegate Mutual Funds*, SEC No-Action Letter (pub. avail. Feb. 7, 1997).

25 *Nicholas-Applegate Mutual Funds*, SEC No-Action Letter (pub. avail. Aug. 6, 1996) (basing relief on the other fund or account having substantially similar investment objectives, policies, and strategies as the mutual fund and the information being: (i) presented in a manner that is not misleading and does not obscure or impede the understanding of required disclosure; (ii) presented with less prominence than the fund performance and accompanies by explanations and disclaimers; and (iii) compared to an appropriate index); and *MassMutual Institutional Funds*, SEC No-Action Letter (pub. avail. Sept. 28, 1995) (basing relief on the fund being "essentially a continuation of" a corresponding separate account).

26 Proposing Release, at 11347, n.26.

27 *Id.*

In deference to the carefully crafted disclosure framework for performance of other funds under the SEC's rules and guidance already applicable to mutual funds, we request that the CFTC provide relief to mutual funds from the CFTC's requirements to disclose Other Performance Information.

- *Performance—Standardized Disclosure of Past Performance:* Commodity pools must disclose standardized return information on a *monthly basis* for the last five years and year-to-date,[28] while mutual funds are required to provide standardized returns on a *calendar year basis* for the last ten years and the year-to-date as of the end of the most recent calendar quarter.[29] CFTC-required commodity pool performance bar chart amounts are required to be net of all fees, expenses and allocations to the CPO,[30] while SEC-required mutual fund performance bar chart "Annual Total Returns" disclosures do not reflect the deduction of sales loads and account fees.[31] The purpose of the SEC's standardized return requirement is to present fund performance in an easily understood format and to enhance the comparability of funds.[32]

  The CFTC specifically requested comment on whether it should "consider harmonizing its past performance reporting requirements with the SEC requirements." We believe that it should. Presenting two separate performance disclosures covering different periods and based on different methodologies in a mutual fund's prospectus would be duplicative and confusing to investors. Also, the SEC has discouraged funds from showing performance for periods of less than one year, as such short-term performance could be misleading to investors.[33] We note that the SEC generally will permit mutual funds to include non-required

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28 17 C.F.R. § 4.25(a)(1)(i)(H).

29 Form N-1A, Item 4(b)(2)(ii)-(iii). Form N-2, Item 4, requires performance to be disclosed on a fiscal year basis.

30 17 C.F.R. § 4.25(a)(1)(i).

31 Form N-1A, Item 4(b)(2), Instruction 1; *see also* Form N-2 Item 4 Instruction 13(b).

32 *See* Form N-1A Performance Data Release.

33 Registration Form Used by Open-End Management Investment Companies, 63 Fed. Reg. 13916, 13922-13923 (Mar. 23, 1998) ("The [SEC] acknowledges that a fund's returns may vary significantly and could decrease in value over short periods and that the annual returns in the bar chart will not necessarily reflect this pattern. On the other hand, the [SEC] is concerned that requiring quarterly returns over a 10-year period would make the bar chart more complex and less useful in communicating information to investors. In balancing the desire to make typical fund investors aware that fund shares may experience fluctuations over shorter periods with its underlying goal that fund documents communicate information in as straightforward and uncomplicated a manner as possible, the [SEC] has determined to require a fund to disclose, in addition to the bar chart, its best and worst returns for a quarter during the 10-year (or other) period reflected in the bar chart. The [SEC] believes that this information will assist investors in understanding the variability of a fund's returns and the risks of investing in the fund by illustrating, without adding unwarranted complexity to the bar chart, that the fund's shares may be subject to short-term price fluctuations.").

information in a registration statement so long as the information is "not misleading" and "does not, because of its nature, quantity, or manner of its presentation, obscure the information that is required to be included."[34] As in the case with Other Performance Information (discussed above), the CFTC's requirement eliminates the registrant's necessary judgment in this regard. The calculation methodologies for preparing the CFTC- and SEC-required bar charts also appear to be in conflict with each other. We are concerned that these differences may cause issues for mutual funds in the context of the SEC disclosure review process among other potential issues.

Moreover, the CFTC has not explained why such duplicative disclosure would be beneficial to investors. We request that the CFTC provide relief from its past performance disclosure requirements for mutual funds in light of the corresponding but different requirements imposed on mutual funds by the SEC.

- *Performance—Draw-Downs and Losses:* A commodity pool must disclose its largest monthly drawn-down (loss) in the last five years and year-to-date[35] and the worst peak-to-valley draw-down for the same time periods. A mutual fund's "Risk/Return Bar Chart and Table" required under the SEC's rules is required to disclose the highest and lowest return for a quarter during the last 10 calendar years or for the life of the fund.[36] If the fund's fiscal year is other than a calendar year, it must disclose the year-to-date return as of the end of the most recent quarter.[37] The purpose of the SEC-required bar chart is to demonstrate the variability and volatility of investor returns over time. The CFTC's comparable but different requirements would be an additional disclosure burden and could confuse investors. We believe that the CFTC can demonstrate the risk of substantial loss to investors by harmonizing this requirement to the SEC disclosure, particularly since CFTC has not explained why this otherwise duplicative disclosure is beneficial to investors.

Break-Even Point Disclosure. A commodity pool is required by the CFTC to disclose a break-even point, which is the trading profit the pool must realize in the first year of a participant's investment in order to recoup all fees and expenses such that a shareholder will recoup its initial investment (*i.e.*, redeem out of the fund an amount of cash equal to the shareholder's initial investment).[38] This disclosure must be included in the forepart of

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34 Registration Form Used by Open-End Investment Companies, 63 Fed. Reg. 13916, 13938 (March 23, 1998).

35 17 C.F.R. §§ 4.25(a)(1)(i)(F), 4.10(k).

36 Form N-1A, Item 4(b)(2)(iii).

37 Form N-1A, Item 4(b)(2)(ii).

38 17 C.F.R. §§ 4.24(d)(5), 4.10(j).

the CPO Disclosure Document. A table depicting how the break-even point is calculated must appear elsewhere in the CPO Disclosure Document. This break-even point must be expressed both as a dollar amount and as a percentage of the minimum unit of initial investment and must assume redemption of the initial investment at the end of the first year of investment. If the break-even point may vary based on the size of the offering, a second break-even point can be calculated based on an assumed amount raised, and the Disclosure Document should also include the break-even point at minimum and maximum level proceeds of the offering. A mutual fund is required to provide an "Example of Fund Expenses" that shows the dollar amount of expenses an investor will pay after 1, 3, 5 and 10 years of investment assuming a 5% rate of return at an assumed level of assets.[39]

We believe that the current Example of Fund Expenses disclosure is better suited for open-end funds given that they are continually offered and have daily changing asset levels. The CFTC should harmonize this requirement to the SEC disclosure. The CFTC stated in the Proposing Release that it believes that the tabular presentation is a "necessary" disclosure because "it mandates a greater level of detail regarding brokerage fees and does not assume a specified rate of return" and it "facilitates an investor's assessment" of a fund. While the Example of Fund Expenses and break-even point disclosure requirements provide similar types of information to allow investors to assess fund expenses, the break-even point is a very different measure of performance and may confuse investors.

We believe that the CFTC has not identified any reason why the break-even point is necessary for an investor to have sufficient information to assess an investment in a mutual fund commodity pool. The CFTC also has not convincingly articulated the reasons why more detailed disclosure regarding brokerage fees[40] and the fact that this disclosure does not assume a rate of return results in disclosure that is more "meaningful" for investors.

Fees and Expenses. CPO Disclosure Documents must include more detailed narrative information regarding fees and expenses than mutual fund prospectuses.[41] This includes fees, commissions and other expenses which the CPO "knows or should have known has

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39 Form N-1A, Item 3, Form N-2, Item 3.

40 It bears noting that the total amount of brokerage fees that a mutual fund pays is disclosed in the SAI. Form N-1A, Item 21.

41 17 C.F.R. § 4.24(i)(1). Regulation 4.24(i) requires a "complete description of each fee, commission and other expense . . . incurred by the pool" including "commissions or other benefits," "professional and general administrative fees and expenses, including legal and accounting fees and office supplies expenses," "costs or fees included in the spread between the bid and asked prices for retail forex transactions," among others. The SEC's fee descriptions are much more streamlined, requiring simply a description of "management fees," "distribution fees," "acquired fund fees and expenses" and "other expenses." Form N-1A, Item 3.

been incurred by the pool for its preceding fiscal year and *is expected to be incurred* by the pool in its current fiscal year."[42] The SEC generally does not require or permit disclosure of "expected" fees and expenses. A mutual fund must base its fee table disclosure on amounts incurred during the prior fiscal year or, if changed, on *current* fees (except for new mutual funds, which must disclose "estimated amounts for the current fiscal year").[43] The SEC has determined that the current mutual fund fee disclosure allows investors to adequately assess the fees associated with their investments in mutual funds, and the CFTC has not identified any reason why additional disclosure is necessary to protect investors. Moreover, disclosing expected fees, and in particular expected brokerage commissions, is predictive, and we are concerned such disclosures could be deemed misleading if projected expenses are more favorable than the actual expenses incurred. Accordingly, we believe CFTC should not apply this Regulation 4.24(i) requirement to mutual funds.

Standard Risk Disclosures: Immediately following its disclosure document cover page, a CPO's Disclosure Document is required to provide certain boilerplate risk disclosure statements. All commodity pools must include boilerplate disclosure statements that (i) commodity interest trading may "quickly lead to large losses" and "restrictions on redemptions" may affect an investor's "ability to withdraw" from the pool and (ii) "commodity pools" may be subject to "substantial charges for management and advisory and brokerage fees" that may deplete or exhaust the fund's assets.[44]

Commodity pools also are required to include boilerplate disclosure statements, if applicable, that address (i) the risks of investing in a pool that trades foreign commodity interests, (ii) the risk that losses may not be limited to the amount of an investor's contribution, (iii) the risk of investing in a pool that engages in off-exchange forex trades, and/or (iv) the risks relating to investing in a pool that engages in swaps transactions.[45]

These disclosures are designed for traditional commodity pools, typically structured as partnerships trading commodity interests to a significant extent and having high leverage, limited portfolio liquidity, and limited redemption rights. In contrast, mutual funds are not subject to these risks. A cornerstone of the SEC's disclosure philosophy is that funds disclose the *principal* risks of investing in the fund attendant to the *principal* investment strategies of the fund, including "the risks to which the fund's particular portfolio as a whole is expected to be subject and circumstances likely to affect adversely the fund's net asset value, yield or total return."[46] In adopting the summary prospectus, the SEC

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42 17 C.F.R. § 4.24(i)(1) (emphasis added).

43 Form N-1A, Item 3, Instructions 3(d) and 6(a).

44 17 C.F.R. §§ 4.24(b).

45 *Id.*

46 Form N-1A, Items 4(b)(1)(i) and 9(c); *cf.* Form N-2, Item 8.

indicated that disclosing non-principal risks obscures the key information investors need to make investment decisions and could therefore be harmful to investors.[47]

Additionally, the CFTC's required risk disclosure statements are not tailored to mutual funds and are inconsistent with multiple regulatory constraints, including as follows:

- The use of the term "commodity pool" in the standard risk disclosure likely will create confusion in the context of an offering document that generally uses the term "fund" to describe the investment vehicle being offered. We believe the term "commodity pool" suggests something other than a mutual fund that invests in derivatives, and that the harmonization should preserve this distinction.

- The disclosure statement regarding risk of loss implies that a fund's loss on one or more commodity trades could lead to the imposition of restrictions on redemptions from the fund. Mutual funds are generally prohibited from suspending shareholder redemptions for more than seven days under Section 22(e) of the 1940 Act, and may only suspend redemptions for longer periods under very limited circumstances.[48] To meet redemption requests, illiquid securities may not constitute more than 15% of the assets of a mutual fund.[49] Open-end mutual funds are prohibited from issuing senior securities, and funds engaging in derivatives transactions must maintain segregated asset accounts that cover their obligations under those contracts or enter into offsetting positions.[50] Mutual funds therefore are not able to subject themselves to the same degree of leverage as traditional commodity pools. We believe that CFTC disclosure to this effect is inaccurate and misleading with respect to mutual funds, which are not subject to the same risk of loss or restrictions on redemptions that may be applicable to traditional commodity pools.

- Under Section 205 of the Investment Advisers Act of 1940, as amended, and Rule 205-2 thereunder,[51] mutual fund investment advisers are not permitted to charge performance fees other than "fulcrum fees" (*i.e.*, the investment adviser may only charge performance-based management fees if the fees are subject to downward

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47 Summary Prospectus Adopting Release, at 4556.

48 15 U.S.C. § 80a-22(e) (permitting restrictions of redemptions for periods when trading on the New York Stock Exchange is closed or restricted, periods of emergencies, and other periods that the SEC provides by order or rule).

49 Statement Regarding "Restricted Securities," 35 Fed. Reg. 19989 (Dec. 31, 1970); Revisions of Guidelines to Form N-1A, 57 Fed. Reg. 9828 (March 20, 1992); 17 C.F.R. § 270.2a-7.

50 15 U.S.C. § 80a-18(f); Securities Trading Practices of Registered Investment Companies, 44 Fed. Reg. 25128 (Apr. 27, 1979).

51 15 U.S.C. § 80b-5(a)(1); 17 C.F.R. § 275.205-2.

adjustment because of poor performance), whereas many traditional commodity pools pay their manager a fee based on assets under management in addition to a traditional performance-based fee. Investment advisers to mutual funds have a fiduciary duty with respect to receipt of compensation from a mutual fund[52] and mutual fund advisory fees are subject to a rigorous approval process by their boards of directors.[53] We do not believe it is accurate to characterize all mutual funds as being subject to "substantial charges" that could require funds to make "substantial trading profits to avoid depletion or exhaustion of their assets." "Exhaustion" of a fund's assets is essentially impossible given the way investment companies are regulated under the 1940 Act.

- If a mutual fund invests in foreign commodity interests, off-exchange forex trades or swaps transactions at a significant level, the mutual fund would be required under Form N-1A and Form N-2 to include *specific* disclosure of the related risks. If these are principal risks they will be prominently disclosed. However, if they are not principal risks, they will not, and should not, be prominently disclosed. Moreover, mutual fund investors' losses *are* limited to the amount of their investments. We believe that disclosures on these topics should be tailored to the particular types of transactions and commodity interest exposure that a specific mutual fund would seek.

More broadly, the SEC has stated that boilerplate, all-capital letter risk disclosure is inconsistent with the plain English disclosure rule under the 1933 Act.[54] We believe that including the CFTC's boilerplate risk disclosure statement as proposed could obfuscate a mutual fund's disclosure of the actual investment risks arising from its investment objective and strategies.[55] We believe these risk disclosures are not necessary for mutual fund investors.

Forepart Disclosure. If each of the commodity pool performance disclosure requirements required to be included in the forepart of a CPO's Disclosure Document are required to be included alongside the corresponding SEC Form N-1A disclosures, the disclosures would conflict with the SEC's requirement that disclosure other than that required in the

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52 15 U.S.C. § 80a-36(b).

53 15 U.S.C. § 80a-15; *Gartenberg v. Merrill Lynch Asset Management Inc.*, 694 F.2d 923 (2nd Cir. 1982); and *Jones v. Harris Associates L.P.*, No. 08-586, 130 S. Ct. 1418 (Mar. 30, 2010).

54 "Using all capitalized letters for the legends does not give them proper prominence. Rather, it makes them hard to read." Plain English Disclosure, 63 Fed. Reg. 6370, 6372 (Feb. 6, 1998).

55 We believe this is particularly true where a fund exceeds the trading limits under Regulation 4.5 by using futures contracts and derivatives primarily to invest incoming cash and gain exposure to the underlying securities markets in an efficient manner, *i.e.*, for "cash equitization" purposes. In such a case, the principal investment risks of the fund often relate to the underlying securities, and not to the use of derivatives as a tool to gain exposure to those markets.

summary section/prospectus not appear in that section ("**Summary Prospectus Content Limit**").[56] Many of these additional disclosure requirements would require mutual funds to move information from the funds' SAIs to their prospectuses. The CFTC stated in the Proposing Release that "information required to be presented in the forepart of the document by § 4.24(d), but that is not included in the summary section of the prospectus for open-ended registered investment companies, may also be presented *immediately following the summary section of the prospectus* for open-ended funds, or otherwise, for registered investment companies using Form N-2, in the forepart of the prospectus."

We acknowledge that this statement appears to allow a mutual fund to comply with the Summary Prospectus Content Limit while still including the CFTC-required disclosures. However, we believe that including similar disclosures in multiple sections of a mutual fund's prospectus (*i.e.*, the required boilerplate disclosure statements in addition to related disclosure on the same topics a mutual fund would include in its principal risks disclosure) would be confusing to investors.[57] We also note that the SEC has carefully designed the mutual fund prospectus to consist of three parts—the prospectus, statutory prospectus and SAI. In this regard, the SEC has continually scaled back the amount of detail in the summary prospectus section of the mutual fund registration statement in order to provide clear and concise information about the significant features of the fund in the summary prospectus while still making additional information available for investors who want it in the statutory prospectus or SAI.[58] In this regard, as noted above, we request that the CFTC defer to the disclosure framework under the SEC's rules already applicable to mutual funds.

Other Disclosure Requirement Issues. The CFTC rules require disclosure of a number of other items that are irrelevant or are substantively duplicative of, but different in form from, similar mutual fund disclosures. These include, among others:

- The aggregate gross capital subscriptions to the pool.[59] A mutual fund's aggregate gross capital subscriptions change daily. The measurement is meaningless to fund investors, as subscriptions are frequently offset, in whole or in part, by redemptions.

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56 Form N-1A, General Instruction C.3(b); *see also* Form N-2, at 4 (stating that the prospectus "should be as simple and direct as possible and should include only information needed to understand the fundamental characteristics of the Registrant[,]" and that "Items 1,2,3, and 4 must appear in order in the prospectus and may not be preceded or separated by any other information."

57 Form N-1A, General Instruction C.3(b).

58 *See* Registration Form Used by Open-End Investment Companies; Guidelines, 48 Fed. Reg. 37928 (Aug. 22, 1983); Registration Form Used by Open-End Investment Companies, 63 Fed. Reg. 13916 (Mar. 23, 1998); and Summary Prospectus Adopting Release.

59 17 C.F.R. § 4.25(a)(1)(i)(D).

- The names of the principals of the fund's CPO, trading manager(s) and its principals, major investee pool(s) and the respective CPO and the principals thereof, major CTAs and principals thereof, and the expected futures commission merchants and/or retail forex dealers.[60] Mutual funds disclose in their prospectuses and/or SAIs: (i) the names and other information of each investment adviser and portfolio manager (including portfolio manager fund share ownership); (ii) control persons (*i.e.*, 25% owners, if any); (iii) principal shareholders (*i.e.*, 5% owners, if any); and (iv) certain information regarding brokers and payments to brokers.[61]

- Detailed information about the investment program and use of proceeds, most importantly the approximate percentage of the pool's assets by type of commodity or market sector, type of security and other categories.[62] Mutual funds typically have flexibility under their principal investment strategies to allocate fund investments in the proportions their advisers deem appropriate under the circumstances. These requirements would be duplicative of SEC disclosures regarding a mutual fund's investment program and principal investment strategies.[63]

- Detailed information about the costs and other details of related party transactions, *i.e.*, transactions for which no publicly disseminated price exists with an affiliate of a fund service provider.[64] This information is generally not applicable to mutual funds given that, absent an exemption, mutual funds are prohibited under Section 17 of the 1940 Act from engaging in transactions with "affiliated persons" of the fund, including its investment adviser and, in many cases, the investment adviser's affiliates.[65]

- Any material administrative, civil or criminal actions *over the past five years*, against the CPO, trading manager, major CTAs, and operators of the pool's major investee pools, and any of the principals of the foregoing, and the FCMs or retail forex dealers of the pool.[66] The SEC requires disclosure of only *pending* material legal actions against the mutual fund or its investment adviser or principal

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60 17 C.F.R. § 4.24(e).

61 Form N-1A, Items 10, 17, 18, 20 and 21.

62 17 C.F.R. § 4.24(h).

63 Form N-1A, Items 2, 4, 9 and 16.

64 17 C.F.R. § 4.24(k).

65 15 U.S.C.§ 80a-17.

66 17 C.F.R. § 4.24(l).

underwriter, and defines "material" as "likely to have a material adverse effect on the fund or the ability of the investment adviser or principal underwriter to perform its contract with the fund."[67]

- Information regarding the ownership interests in a pool of its CPO, trading manager, CTAs and investee pools, and each of the foregoing's principals.[68] As noted above, mutual fund portfolio manager, control person and principal holder disclosure is somewhat duplicative of but also different from the CFTC requirements.

Each of these CFTC required disclosure items elicits highly detailed information, which we believe is not necessary to allow a mutual fund investor to make an informed investment decision. Mutual funds should not be subject to these duplicative and/or confusing disclosures, and instead the CFTC should defer to the SEC.

Differences between the CFTC's and SEC's Disclosure Amendment Requirements Create Serious Issues for Mutual Funds

CFTC Requirements

CFTC Regulation 4.21 generally requires that a CPO that is registered (or required to be registered) under the Commodity Exchange Act, as amended ("**CEA**"), deliver a Disclosure Document to each prospective pool participant by no later than the time the CPO delivers a subscription agreement for the pool to that prospective pool participant.[69] Regulation 4.21 further requires that, before accepting funds, securities or other property from the prospective participant, the CPO must first receive a signed and dated acknowledgement from the prospective participant that the participant received a Disclosure Document for the pool.[70]

CFTC Regulation 4.26 requires that, if a CPO knows or should know that a pool's Disclosure Document requires an amendment to correct an inaccuracy or omission of information, the CPO must correct the defect and distribute the correction to (i) all existing pool participants within 21 days of learning of the defect and (ii) each previously solicited prospective pool participant in advance of accepting or receiving funds, securities or other property from such prospective participant.[71] The correcting

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67 Item 10(a)(3) of Form N-1A and related instruction.

68 17 C.F.R. § 4.24(t).

69 17 C.F.R. § 4.21(a)(1)

70 Delivery of the document, as well as acknowledgement of receipt, may be conducted electronically. 17 C.F.R. §4.21(b).

71 17 C.F.R. § 4.26(c)(1).

amendment to the Disclosure Document may be distributed either in the form of an amended Disclosure Document or profile document, a sticker affixed to the Disclosure Document, or other similar means.[72]

In May 2011, the CFTC provided relief from certain disclosure, shareholder reporting and recordkeeping requirements for registered CPOs of commodity exchange-traded funds ("**Commodity ETFs**"), discussed further below.[73] Rather than fulfilling the CFTC Regulation 4.21 requirement that CPOs deliver, and receive acknowledgement of receipt for, a Disclosure Document, CPOs qualifying for this relief must only make the pool's Disclosure Document available on a website and notify prospective pool participants of the online location at which the Disclosure Document is available. There is no requirement that the CPO notify pool participants of amendments or changes to the document, only that the version of the Disclosure Document available online be kept up to date.[74]

Securities Law Requirements

Under securities laws and regulations, a mutual fund is required to provide a fund prospectus with or before the delivery of any fund shares to a new investor.[75] Since 2009, mutual funds have been permitted to distribute a short, summary version of the prospectus, rather than the full document, provided that the full prospectus is available for physical delivery upon request.[76] The fund must also provide, free of charge, on the internet, the fund's current summary prospectus, statutory prospectus, SAI, and most recent annual and semi-annual reports to shareholders and supplementary filings, or "stickers."[77] The mutual fund's prospectus must be updated on an annual basis.[78] If a mutual fund makes changes to its prospectus disclosure between annual updates, the fund must update the version it maintains online on its website and on EDGAR.[79] The mutual

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72 17 C.F.R. § 4.26(c)(2). The CPO must also file amendments to the Disclosure Document electronically with the NFA. 17 C.F.R. § 4.26(d)(2).

73 Commodity Pool Operators: Relief From Compliance With Certain Disclosure, Reporting and Recordkeeping Requirements for Registered CPOs of Commodity Pools Listed for Trading on a National Securities Exchange; CPO Registration Exemption for Certain Independent Directors or Trustees of These Commodity Pools, RIN 3038-AC46, 76 Fed. Reg. 28641 (May 18, 2011) ("**Commodity ETF Relief**").

74 17 C.F.R. § 4.12(c). The CPO is required to keep a current copy of the Disclosure Document on file with the NFA.

75 Section 5(b)(2) of the 1933 Act.

76 Summary Prospectus Adopting Release.

77 These materials must also be filed with the SEC and are publicly available through the EDGAR system.

78 Section 10(a)(3) of the 1933 Act.

79 Rule 497 under the 1933 Act; Securities and Exchange Commission Generic Comment Letter, Comment II.B—Mutual Funds Sold by Financial Institutions (Feb. 25, 1994).

fund may exercise its discretion as to whether it is necessary to alert current shareholders of the change, based on an analysis of the materiality of the change. Recent material changes to prospectus disclosure, and the reasons underlying those changes, may be discussed in annual and semi-annual reports to shareholders.

We request that the CFTC defer to the SEC on what registration statement supplements must be mailed to shareholders. In keeping with the spirit of the Commodity ETF relief provided by the CFTC, and the SEC's modernization of disclosure practices to match the way investors use the internet to analyze investment options, we submit that the current practice of posting a supplement to the mutual fund's website, and filing the supplement on EDGAR, provides sufficient disclosure to investors.

CFTC Disclosure Requirements as Applied to Mutual Funds Extend Beyond the CFTC's Stated Goals for Adopting the Regulation 4.5 Amendments

We believe that requiring mutual funds to comply with ongoing disclosure, shareholder reporting and recordkeeping requirements is not consistent with the CFTC's stated goals in adopting the Regulation 4.5 amendments that require mutual fund CPO registration with the CFTC. In the Adopting Release, the CFTC stated that it "determined to require registration of certain previously exempt CPOs" (*i.e.*, CPOs of mutual funds and certain others) "and to further require reporting of information comparable to that required in Form PF" in order to (i) provide the CFTC with information to address certain sources of risk delineated in the Dodd-Frank Act[80] and (ii) implement "enhanced oversight" of the derivatives markets and mutual fund commodity interest trading activities.[81] The Adopting Release also stated, in the context of the CFTC's cost-benefit analysis of the amendments to Regulation 4.5, that "there currently is no source of reliable information regarding the general use of derivatives by registered investment companies."[82] The CFTC further stated in the Adopting Release that:

> Although the Commission believes the modifications to § 4.5 enhance the Commission's ability to effectively oversee the derivatives markets, *it is not the Commission's intention to burden registered investment companies*

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80 Dodd-Frank Act. The CFTC noted that the Dodd-Frank Act requires the reporting of information "related to potential systemic risk including, but not limited to, the amount of assets under management, use of leverage, counterparty credit risk exposure, and trading and investment positions" for each fund, which "facilitates oversight of the investment activities of funds within the context of the rest of a discrete market or the economy as a whole." Adopting Release, at 11253.

81 Adopting Release, at 11253. The proposing release relating to these amendments stated that the CFTC was reevaluating its regulation of CPOs "in order to ensure that the [CFTC] can adequately oversee the commodities and derivatives markets and assess market risk associated with pooled investment vehicles under its jurisdiction." Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 76 Fed. Reg. 7976, 7977-78 (Feb. 11, 2011).

82 Adopting Release, at 11275.

> *beyond what is required to provide the Commission with adequate information it finds necessary to effectively oversee the registered investment company's derivatives trading activities*. Through [the Proposed Rules], the Commission intends to minimize the burden of the amendments to § 4.5.[83]

The CFTC also suggested, in requesting comment on the Proposing Release, that the CFTC has an objective in proposing the harmonization rules "of providing material information to pool participants, and reducing duplicative or conflicting disclosure."[84]

We believe that the CFTC can achieve its goal of obtaining reliable information on the use of derivatives by mutual funds whose advisers are subject to dual CFTC and SEC regulation by collecting data pursuant to CFTC Regulation 4.27[85] on the CFTC's new Forms CPO-PQR and CTA-PR, and by reviewing materials mutual funds already produce that are publicly available, without subjecting mutual funds to its full CPO disclosure, shareholder reporting and recordkeeping regime. As discussed above, we believe that the current mutual fund disclosure provides adequate information to investors. Requiring mutual funds to modify their disclosures to investors will not enhance the CFTC's ability to collect information required under the Dodd-Frank Act and oversee the derivatives markets or mutual funds' use of derivatives. This goes beyond the CFTC's stated goals for the Regulation 4.5 amendments and contradicts the idea that the burden on mutual funds be limited to what is required for information-gathering purposes.

As noted herein, the CFTC disclosure requirements would be confusing, costly and conflicting with the SEC disclosure requirements, and application of the CFTC's disclosure requirements to mutual funds could be extremely burdensome. Moreover, the CFTC has not presented any evidence that the additional information that would be required under Regulations 4.24 and 4.25 (*e.g.*, other pool performance and a break-even point) will assist the CFTC in market surveillance.

In light of these concerns, we request that the CFTC defer to the expertise of the SEC regarding mutual fund disclosure, shareholder reporting and recordkeeping requirements, which has been developed over decades of firsthand experience and objective research and is carefully tailored to protect retail mutual fund investors.

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83 *Id.*, at 11255 (emphasis added).

84 Proposing Release, at 11348.

85 17 C.F.R. §4.27.

Providing the Same Relief as for Commodity ETFs is Welcome, But Does Not Go Far Enough

The CFTC's proposed extension of the relief it has provided to Commodity ETFs under CFTC Regulation 4.21 ("**Regulation 4.21**")[86] is a welcomed and necessary starting point or baseline for any mutual fund required to operate under dual regulation.[87] However, as noted above, mutual funds and Commodity ETFs are different, and accordingly the relief granted to Commodity ETFs does not go far enough to ensure that affected mutual funds will be able to operate without significant additional and burdensome requirements and expense, if subject to dual regulations. As discussed in this comment letter, the CFTC must go further in addressing inconsistencies and duplications in the content of disclosure documents for mutual funds.

Reporting and Recordkeeping Relief

The CFTC requested comment on whether it should "consider harmonizing its account statement reporting requirement with the SEC's semi-annual reporting requirement."[88] The SEC currently requires that mutual funds report to shareholders on an annual and semi-annual basis. In addition, mutual funds disclose their portfolio holdings at the end of each quarter on either Form N-Q or Form N-CSR. The requirement that a mutual fund provide a monthly account statement would substantially increase the frequency of mutual fund shareholder reporting. The CFTC stated that it was not proposing to modify the reporting frequency for mutual funds because the "information required to prepare the account statement should be readily available to the operator of an investment vehicle maintaining records of its trading activity and other operations in accordance with recordkeeping requirements under the [CEA] and applicable securities laws."[89] While the information may be available to generate monthly reports, the CFTC has not justified their production in terms of its stated intent of market surveillance, as the monthly account statements are not filed with the NFA or the CFTC. But alternatively, the CFTC will also have access to other information regarding mutual fund commodity interest trading activities collected on Form CPO-PQR and Form CTA-PR and by reviewing mutual fund materials already produced and made publicly available on mutual fund websites and EDGAR.

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86 *See* Commodity ETF Relief.

87 Proposing Release, at 11346.

88 The Proposed Rules would allow a mutual fund commodity pool's CPO to satisfy the requirements under Regulation 4.22 that it deliver a monthly "account statement" to investors and by posting the account statement on an Internet website maintained by the CPO. We agree that it is appropriate to permit posting of these reports (and mutual funds' annual reports) on an Internet website rather than requiring delivery to investors.

89 Proposing Release, at 11347.

We also believe that the CFTC should defer to the expertise of the SEC regarding the frequency of reporting to shareholders that is necessary to provide sufficient information about their investments in a mutual fund. We request that the CFTC defer to the SEC and allow mutual funds to provide account statements to shareholders on a semi-annual basis, or identify a reason why the CFTC believes that providing account statements to shareholders on a monthly basis is necessary for the protection of investors and justifies the additional cost to them.

The Proposed Rules would also grant a mutual fund relief from the Regulation 4.23 requirement that a CPO maintain its required books and records at its main business offices, consistent with the relief available to Commodity ETFs discussed above, but that relief does not go far enough. This would permit a mutual fund to maintain its books and records with an existing fund service provider, namely the fund's administrator, distributor or custodian or a bank or registered broker or dealer acting in a similar capacity with respect to the fund, so long as the fund (i) notifies the CFTC of where it is maintaining its records via a notice of claim for exemption pursuant to Regulation 4.12 and (ii) discloses such arrangements in its Disclosure Document. However, this would not permit a mutual fund to maintain its records with a third party professional recordkeeping service that serves in no other capacity to the mutual fund. Use of a third party record-keeper is a standard mutual fund industry practice. We believe that the CFTC has not provided any reason why stipulating eligible service providers would serve either of the CFTC's two stated purposes in adopting the amendments to Regulation 4.5. We believe that the CFTC's proposed relief from the recordkeeping requirements under Regulation 4.23 does not go far enough to permit current arrangements that mutual funds maintain with service providers. We request that the CFTC defer to the SEC and provide relief from this requirement.

We also note that Regulation 4.23(a)(4) requires that the CPO keep a subsidiary ledger or other record regarding each participant in the pool. This is inconsistent with mutual fund industry practice with respect to ownership of mutual fund shares by intermediaries through omnibus account and Networking Level 3 account arrangements maintained by financial intermediaries, such as broker-dealers or banks. Applying this requirement to the underlying shareholder in omnibus and networked accounts could severely restrict this common industry practice. If the relevant financial intermediaries are not considered the "participants" for purposes of this recordkeeping requirement, either the shares would not be able to be held in omnibus or Networking Level 3 accounts or the omnibus and Networking Level 3 accounts would need to be "pierced." Omnibus accounts are an arrangement that provides for greater ease of management of investor accounts. Mutual fund shares are held in hundreds of thousands of omnibus accounts.[90] Piercing omnibus

[90] When the SEC adopted redemption fee rules in 2006 that related to omnibus accounts, commenters reported that hundreds of thousands of accounts could qualify as being held by financial intermediaries. Mutual Fund Redemption Fees, 71 Fed. Reg. 58257, 58264 n.62 (Oct. 3, 2006).

accounts or discontinuing the practice of using omnibus accounts for mutual funds whose investment advisers cannot qualify for the Regulation 4.5 CPO exclusion would make mutual fund distribution impossible with no ascertainable additional shareholder protection. We request that the CFTC confirm that mutual funds may consider the relevant financial intermediaries to be the mutual funds' "participants" for purposes of Regulation 4.23. This relief would be consistent with the current practice of ETFs. An ETF generally has a limited number of authorized participants who hold all of the outstanding shares of the ETF and comprise the "investors" for purposes of Regulation 4.23. Notwithstanding their ownership of the ETF's shares, the authorized participants are not the ultimate beneficiaries of the ETF's performance. Similarly, the intermediaries that hold a mutual fund's shares are not the ultimate beneficiaries of the mutual fund's performance, but should be counted as the mutual fund's investors to allow for compliance with Regulation 4.23(a)(4).

CFTC and SEC Must Harmonize Disclosure in a Joint Effort (Including the NFA and FINRA) Rather than Simply Seeking to Remove Impediments to Additional Disclosure

The CFTC must consider whether the information its regime requires provides additional necessary and cost-effective material information for an investor to make an informed investment decision compared to what disclosure is already required, and whether such information is not misleading or confusing. Given the SEC's long-standing experience with addressing retail investor needs in mutual funds, the CFTC should defer to the SEC absent some reason otherwise, especially where the matter is one simply of form rather than substance. However, if the CFTC is determined that dually-registered advisers meet CFTC commodity pool disclosure requirements for mutual funds in addition to those required by the SEC, the CFTC and SEC should engage in a joint rulemaking to create an integrated registration form in which additional disclosures could be included in the mutual fund SAI.

Major changes to the established mutual fund disclosure regime should not be undertaken lightly or without careful consideration by all relevant regulatory authorities. The two relevant self-regulatory organizations, the Financial Industry Regulatory Authority ("**FINRA**") and the National Futures Association ("**NFA**"), should be consulted as part of such joint rulemaking. Given the amount of study and coordination with multiple stakeholders that will be necessary, we believe that the CFTC is not ready to finalize its proposed harmonization rules.[91]

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[91] The fact that the CFTC has only had "*preliminary* discussions with SEC staff" on, for example, the requirement that other pool performance and accounts may be presented in the mutual fund's SAI is indicative of this. Proposing Release, at 11347 n. 26 (emphasis added).

Because mutual funds are continuously offered, and many mutual funds that will be affected by the Regulation 4.5 changes are already in operation, expecting such funds to seek no-action relief from the SEC, as discussed above, is not feasible, is not good regulatory policy, and would impose costs not previously anticipated or disclosed. Although the CFTC reports that the SEC staff would "consider" granting such relief, the SEC staff would, of course, be under no obligation to do so. If such relief is not forthcoming in a timely manner, funds would be caught in an untenable situation, trying to comply with two inconsistent sets of regulations while being effectively unable to cease offering their shares without enormous fall-out. As multiple no-action requests should be expected, it makes an argument for deferring to the SEC disclosure regime *now* and codifying relief. Such certainty in applicable laws and regulations is imperative for the operation of orderly markets. Mutual funds cannot be expected to operate in the uncertain regulatory environment that would result from portions of the CFTC's proposal.

Administrative Procedures Act and Regulatory Efficiency

As the CFTC well knows, the requirements of the Administrative Procedures Act ("**APA**"),[92] which include performing a cost-benefit analysis as detailed in Section 15(a) of the CEA, apply to the CFTC's process for considering and implementing CFTC disclosure, shareholder reporting and recordkeeping requirements that will impact mutual funds whose advisers are dually-registered.[93]

Cost-Benefit Analysis

The cost of regulating mutual funds, America's favorite collective investment vehicle, is already very high. The costs of compliance with the CFTC disclosure, shareholder reporting and recordkeeping requirements—even with modifications—have the potential to increase costs significantly per sponsor, per fund and industry-wide. In taking any additional regulatory action, the CFTC should carefully consider and account for additional costs and benefits to the U.S. investing public and the commodity markets. Furthermore, a cost-benefit analysis must take into consideration the CFTC's stated reasons for its Regulation 4.5 amendments and its intent not "to burden [mutual funds] beyond what is required to provide the [CFTC] with adequate information it finds necessary to effectively oversee the [mutual fund]'s derivatives trading activities."[94] We believe that it is imperative for the CFTC to determine the likely economic consequences for mutual funds of the imposition of CFTC disclosure, shareholder reporting and recordkeeping requirements and their effect on the mutual fund industry. As the CFTC staff learned at the roundtable it held for industry participants on July 6, 2011 to discuss

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92 5 U.S.C. §§ 551-559.

93 7 U.S.C. § 19(a).

94 Proposing Release, at 11255.

the CFTC's proposed changes to its Part 4 regulations ("**July 6 Roundtable**"), mutual funds typically consider compliance costs, disclosure preparation and filing and reporting to shareholders to be fund expenses because they are undertaken to comply with requirements directly applicable to the fund.[95] As a result, these costs will be borne by shareholders rather than being covered by the sponsor or adviser. Investors will disproportionally and inappropriately bear the costs of the CFTC's "enhancements" to the mutual fund regulatory regime, enhancements for which there is no evidence investors or even the CFTC have a need. The CFTC's stated aim of improving transparency and commodity market integrity and protection could be achieved by other means already available to the CFTC, including, for example, large trader reporting on Form 40. Making documents available electronically, as the CFTC has already determined to do,[96] would mitigate printing and mailing costs, but not the preparation costs associated with additional disclosure and reporting. The CFTC needs to balance the impact of additional expenses on shareholder returns against any added benefit to be derived from any new disclosure, reporting and other additional regulatory requirements.

The CFTC has done an inadequate job of conducting a cost-benefit analysis, even without the benefit of industry data. We believe this comment letter provides evidence of the clear burdens that the CFTC has not recognized or genuinely accounted for in these harmonization proposals. Moreover, by bifurcating its Regulation 4.5 amendments into a final rule addressing the requirements for continued qualification for the CPO exclusion and a proposed rule addressing harmonization of operational requirements, the CFTC has permitted itself to consider its present harmonization efforts to be cost-reducing rather than what the sum total of the Regulation 4.5 changes really are, which is cost-increasing. Framing the cost-benefit analysis as such is a logical fallacy. To that end, the CFTC's analysis has been inadequate in each of the five broad areas of market and public concern it must assess under the CEA:

- *Protection of Market Participants and the Public* – The CFTC has not demonstrated how the disclosure changes for mutual funds, shareholder reporting and compliance with recordkeeping requirements will help with the achievement of the regulatory objectives of its Part 4 registration requirements. Whereas compliance with the disclosure, shareholder reporting and recordkeeping requirements for dual-registrants might be less burdensome for a mutual fund's investment adviser than full Part 4 compliance, requiring compliance with both the SEC and CFTC operational requirement regimes will *overall* significantly increase costs for mutual funds.

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95 We understand that the ICI has surveyed its members regarding anticipated costs of compliance. Such a survey necessarily involves certain assumptions because, for instance, the swaps regulations have yet to be finalized. We hope that the CFTC will seriously study data that the ICI has been able to collect.

96 Commodity ETF Relief, at 28644-28645.

- *Efficiency, Competitiveness and Financial Integrity of Futures Markets* – The same argument applies here. The CFTC has framed the issue as one of fewer burdens for dual registrants, but failed to consider overall increased costs for mutual funds. Mutual funds whose investment advisers will be subject to dual registration have not been heretofore operated as public commodity pools and then been granted some relief. Instead they have been operated as mutual funds and are being further burdened.

- *Price Discovery* – The CFTC's statement that it has not identified a specific effect on price discovery fails to recall the reason the CFTC liberalized Regulation 4.5 in 2003. The CFTC's intent was to bring more participants into the commodity futures and commodity options markets to increase liquidity, which in turn facilitates price discovery.[97] This objective has been overwhelmingly achieved, and investors and markets have benefited. To the extent that mutual funds exit the market or reduce their trading in order to continue to qualify for the Regulation 4.5 exclusion, those actions will have the effect of removing liquidity from the markets. In addition, as the CFTC learned at its July 6 Roundtable, because mutual fund expenses are passed on to shareholders in the form of asset based fees, to the extent ongoing operational requirements create more expenses, mutual funds will have fewer assets to deploy into the markets.

- *Sound Risk Management* – The CFTC's purported reason for the Regulation 4.5 changes was to increase its ability to monitor risk in the markets. CFTC disclosure, shareholder reporting and recordkeeping requirements would do nothing to assist the CFTC with this task.

- *Other Public Interest Considerations* – The CFTC has failed to consider that mutual funds are an important vehicle for retirement and college saving. Costs incurred with this investment will affect Americans' ability to retire, go to college, or meet whatever other savings goal they have.

Where the CFTC's cost-benefit analysis is lacking, it opens itself up to potential challenges under the APA.[98]

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97 2003 Amendments, at 47223 (stating that the CFTC's intention was "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.").

98 The CFTC's changes to Regulation 4.5 are now the subject of a legal challenge that the ICI and the Chamber of Commerce of the United States of America have brought in the United States Court for the District of Columbia. Complaint for the ICI and the Chamber of Commerce of the United States of American (D.D.C.) (No. 1:12-cv-00612).

Notice and Opportunity to Comment

A final rule that does not address and reconcile identified conflicts and issues would be not only burdensome and costly for industry participants, but could be unworkable. Compliance as a dual registrant would be very challenging under the current and proposed regimes. Despite receiving detailed comment letters from the industry on all aspects of its Regulation 4.5 amendments, the CFTC has failed to reconcile all of the aspects of the proposed rulemaking, rendering its proposed regime largely unworkable for industry participants. Where the CFTC fails to provide industry participants adequate notice and opportunity to comment on proposed changes, it opens itself up to potential challenges under the APA.

Regulatory Efficiency

Although not directly applicable to the CFTC, as a general matter, the CFTC's bifurcated approach to its dual regulation and harmonization is in direct conflict with one of the central tenants of Executive Order 13,563 ("**Executive Order**"), which directs regulatory agencies to "tailor [their] regulations to impose the least burden on society, consistent with obtaining regulatory objectives, taking into account, among other things, and to the extent practicable, the *costs of cumulative regulations*."[99] Although presented in two parts, the CFTC's amendments to Regulation 4.5 and accompanying proposed amendments to disclosure, shareholder reporting and recordkeeping requirements to make dual-registration possible are really a single rulemaking, the cumulative cost of which the CFTC ought to recognize and address as a unit.

In addition, the CFTC's proposed approach applicable to dually-registered mutual fund advisers is contrary to Section 3 of the Executive Order. In Section 3, the Executive Order recognizes that "[s]ome sectors and industries face a significant number of regulatory requirements, some of which may be redundant, inconsistent, or overlapping." Registered investment advisers to mutual funds that cannot meet the new Regulation 4.5 conditions for exclusion from CPO registration and are therefore subject to dual regulation by the CFTC and SEC will be subject to overlapping regulation. In such a situation, the Executive Order calls for:

> [g]reater coordination across agencies [to] reduce these requirements, thus reducing costs and simplifying and harmonizing rules. In developing regulatory actions and identifying appropriate approaches, each agency shall attempt to promote such coordination, simplification, and

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[99] Improving Regulation and Regulatory Review, Exec. Order 13,563, 76 Fed. Reg. 3821 (Jan. 21, 2011) (emphasis added). Because the CFTC is an independent agency under 44 U.S.C. § 3502(b)(5), the Executive Order does not necessarily apply to it; however, its tenants make logical sense for a well run government. It is hard to argue that agencies subject to the Executive Order should take into account the cumulative cost of regulations while the independent agencies are free to do the opposite.

> harmonization. Each agency shall also seek to identify, as appropriate, means to achieve regulatory goals that are designed to promote innovation.

The duplicative, confusing and potentially conflicting disclosure that would result from the CFTC's harmonization proposal would run contrary to this illustrative executive direction for governmental agencies. If the CFTC does not defer to the SEC on matters of disclosure, shareholder reporting and recordkeeping, it should at least coordinate with the SEC on the same.

Conclusion

We continue to oppose the changes to Regulation 4.5 and the related disclosure harmonization proposal. However, if the CFTC determines to move forward with its proposal to overlay CPO disclosure document, shareholder reporting and recordkeeping requirements on top of the existing and extensive SEC requirements for mutual funds, the CFTC should carefully consider what, if any, additional CFTC concerns are not addressed by the SEC's requirements and how most effectively to craft new requirements that address the CFTC's concerns. We request that the CFTC only re-propose those rules for which the CFTC first identifies a specific need to be applicable to mutual funds whose investment advisers will be subject to dual regulation. To this end, we recommend that the CFTC engage in a joint rulemaking effort with the SEC to develop an appropriate integrated regulatory regime applicable to mutual fund commodity pools that would alleviate the conflicts, confusion and duplication discussed herein. Otherwise, we request that the CFTC defer to the SEC on matters involving mutual fund disclosure, shareholder reporting and recordkeeping requirements.

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Thank you for considering our views on this important topic. If you have any questions or if we can provide any additional information that may assist the CFTC and its staff, please contact Jack Murphy at 202.261.3303 or jack.murphy@dechert.com, M. Holland West at 212.698.3527 or holland.west@dechert.com, Brendan Fox at 202.261.3381 or brendan.fox@dechert.com, Philip Hinkle at 202.261.3460 or philip.hinkle@dechert.com, Audrey Wagner at 202.261.3365 or audrey.wagner@dechert.com or Andrea Baron at 202.261.3444 or andrea.baron@dechert.com.

Respectfully submitted,

/s/ Dechert LLP

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