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

July 30, 2014

Via Electronic Submission: secretary@cftc.gov

The Hon. Timothy G. Massad
Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: Managed Funds Association Regulatory Priorities

Dear Chairman Massad:

Managed Funds Association ("**MFA**")[1] congratulates you on becoming the new Chairman of the Commodity Futures Trading Commission (the "**Commission**" or "**CFTC**"). We also extend our congratulations to Commissioners Bowen and Giancarlo. We commend the leadership of Acting Chairman Wetjen and Commissioner O'Malia during the interim period prior to your arrival. We look forward to continuing a constructive and cooperative relationship with the Commission under your leadership.

We wish to outline MFA's priority issues and related requests concerning the Commission's regulation of the U.S. swaps market and registered Commodity Trading Advisors ("**CTAs**") and Commodity Pool Operators ("**CPOs**") for your consideration in setting the Commission's agenda and priorities. We welcome the opportunity to meet with you to discuss MFA's priority issues and requests in greater detail.

MFA has over 3,000 members from firms engaging in many alternative investment strategies all over the world. The industry's assets are at a record high of nearly $2.4 trillion. MFA supported the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").[2] In particular, MFA has consistently supported the Dodd-Frank Act's Title VII reforms to the over-the-counter ("**OTC**") derivatives markets that decrease systemic risk,

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[1] Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent and fair capital markets. MFA, based in Washington, DC, is an advocacy, education and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

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

increase transparency, and promote an open, competitive, and level playing field. We welcomed the market's transition to central clearing for liquid, standardized swaps that occurred over the course of 2013, and actively engaged in the market's evolution of trading liquid, standardized, cleared swaps on registered swap execution facilities ("**SEFs**") and designated contract markets ("**DCMs**") that commenced earlier this year. We outline MFA's priorities below.

I. Executive Summary

A. MFA Priority Swaps Issues and Requests

In Section II of this letter, we discuss MFA's short-term priority issues and requests concerning the CFTC's regulation of the U.S. swaps market. These issues, outlined below, are those that need the Commission's attention in the next few months to ensure the continued effective functioning of the U.S. swaps market.

- **Impartial Access to SEFs and SEF Implementation Concerns.** MFA respectfully requests that the Commission prioritize the staff's substantive review of SEF rulebooks and SEFs' compliance with core principles to remove remaining practical impediments to investors' impartial access to SEFs. With respect to SEF trading of "package" transactions (*i.e.*, transactions that involve the simultaneous and contingent execution of two or more instruments that are priced or quoted together as a single economic transaction ("**Package Transactions**")), MFA specifically requests that the Commission consider revising the compliance timeline until critical market infrastructure for the various types of Package Transactions is completed, tested and ready for widespread commercial use by swap market participants.

- **Exemption for SEF Members that are Registered CTAs/CPOs from Rule 1.35(a)'s Oral and Written Recordkeeping Requirements.** MFA respectfully requests that the Commission grant a permanent exemption for SEF members that are registered CTAs/CPOs from amended CFTC Rule 1.35(a)'s oral and written recordkeeping requirements.

- **Swap Data Reporting Issues.** MFA respectfully requests that the Commission prioritize improvements to its swap data reporting regime to enhance its utility for regulators and the marketplace, improve the cost-efficiency of reporting, and enhance protection of customer information.

- **Cross-Border Issues.** MFA emphasizes that, to ensure the continued robustness of the derivatives markets, it is critical that the Commission, and other U.S. and European policy makers and regulators promptly: (1) approve and recognize central counterparties ("**CCPs**") organized outside their jurisdiction (*i.e.*, third country CCPs); and (2) resolve conflicting regulatory requirements that arise for alternative investment funds ("**AIFs**") and their counterparties under the Dodd-Frank Act and the European Market Infrastructure Regulation ("**EMIR**") due to interpretations of where AIFs are "established" for purposes of EMIR.

B. Regulation of Commodity Pool Operators and Commodity Trading Advisors

In 2011, the Commission eliminated an exemption from registration for managers of private investment vehicles—many, if not most, of which are already subject to separate legal and regulatory frameworks. As a result, the Commission has hundreds more new CPOs and CTAs under its regime, including many that operate/advise non-traditional commodity pools (*e.g.*, hedge funds, fund-of-funds, private equity funds, real estate investment trusts and securitizations) and are subject to multiple legal and regulatory regimes. Many of these new CPOs and CTAs are finding that aspects of the Commission's part 4 regulations, which were not developed with these types of firms in mind, are very burdensome, create confusion for investors, and in some cases, just do not make sense with respect to their business models. This change led to a large number of requests for relief and guidance, which have placed a huge strain on the Commission's limited resources. We respectfully request that the Commission engage in rulemaking and provide interim relief in a few specific areas, as further explained in Section III of this letter, which would be the most effective use of the Commission's resources and would greatly facilitate registrants' compliance.

- **Delegation of CPO Obligations.** MFA respectfully requests that the Commission engage in rulemaking to address "CPO Delegation", providing interim relief to address the widespread industry need for relief due to the nature of common investment fund structures, and providing legal consistency with respect to corporate entities of public and private funds.

- **CPO/CTA Recordkeeping Requirements.** MFA respectfully urges the Commission to consider rulemaking and temporary time-limited no-action relief pursuant to our petition on CPO and CTA recordkeeping rules. As explained below, CPOs and CTAs are finding technical compliance with the Commission's recordkeeping regulations unduly burdensome and costly due to the regulations' incorporation of outdated technology and incongruity with standard market practices, particularly with respect to electronic recordkeeping and third-party recordkeepers.

- **CFTC/SEC Harmonization Issues.** MFA respectfully requests that the Commission engage in rulemaking to harmonize CFTC regulations for CPOs and CTAs with Securities and Exchange Commission ("**SEC**") regulations with respect to investment advisers and private placements to reduce compliance burdens for persons registered with both the CFTC and SEC. In particular, we request harmonization with respect to the Jumpstart Our Business Startups Act (the "**JOBS Act**") equivalence; quarterly reports and audited financial statements; and systemic risk reporting.

C. Protection of Customer Collateral Issues

In recent years, policy makers and regulators, including the Commission, have recognized weaknesses in the customer protection regime and implemented important measures to strengthen the protections available to customers.[3] MFA supports these efforts, and encourages the Commission to take additional steps to strengthen the legal framework applicable to protection of customers and to be wary of adopting certain measures that would erode existing customer protections. In Section IV of this letter, MFA urges the Commission to consider the following particular matters that could help or hinder the protections available to customers' collateral:

- **Recovery and Resolution of Financial Market Infrastructures.** MFA is concerned about global authorities' consideration of using customer margin as a *pro rata* loss allocation tool during the recovery or resolution of CCPs. MFA believes that effective regulation should focus on preventing CCP failure *ex ante*, and we ask the Commission to ensure that its regulations do not permit the *pro rata* use of customer margin as a CCP recovery or resolution tool.

- **Protection of Cleared Swaps Customer Collateral.** MFA requests that the Commission encourage Congress to amend Chapter 7 of the Bankruptcy Code to permit enhancements to customer protections. Amending Chapter 7 of the Bankruptcy Code would: (1) ensure that, upon the insolvency of a futures commission merchant ("**FCM**"), cleared swaps customer collateral would not be subject to *pro rata* distribution; (2) enhance the effectiveness of the Commission's adopted "legal segregation with operational commingling" model ("**LSOC**") for cleared swaps; and (3) allow market participants to consider other enhancements to customer protections, such as optional full physical segregation of customer collateral.

- **Protection of Futures Customer Collateral.** In light of the failures of MF Global, Inc. ("**MF Global**")[4] and Peregrine Financial Group, Inc. ("**Peregrine**"),[5] MFA

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[3] *See* Sections 724 and 763 of the Dodd-Frank Act, incorporating provisions relating to segregation of collateral. *See, e.g.*, Commission final rule on "Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations", 78 Fed. Reg. 68506 (November 14, 2013), available at: http://www.gpo.gov/fdsys/pkg/FR-2013-11-14/pdf/2013-26665.pdf ("**Customer Protection Rules**"); and Commission final rule on "Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions", 77 Fed. Reg. 6336 (February 7, 2012), available at: http://www.gpo.gov/fdsys/pkg/FR-2012-02-07/pdf/2012-1033.pdf ("**LSOC Rule Release**").

[4] *See* Final Consent Order of Restitution, Civil Monetary Penalty and Ancillary Relief Against MF Global Inc., U.S. Commodity Futures Trading Commission v. MF Global Inc., MF Global Holdings Ltd., Jon S. Corzine, and Edith O'Brien, (Civil Action No. 11 Civ. 7866, S.D.N.Y., November 8, 2013) available at: http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/enforcementaction/enfmfglobalorder110813.pdf (describing MF Global's settlement of its charges by providing restitution of the approximately $1 billion lost by all commodity customers when the firm failed on October 31, 2011).

[5] *See* Complaint for Injunctive and Other Equitable Relief and Civil Monetary Penalties Under the Commodity Exchange Act, U.S. Commodity Futures Trading Commission v. Peregrine Financial Group, Inc. and Russell R. Wasendorf, Sr. (Civil Action No. 12 Civ. 05383, N.D. Ill., July 10, 2012), available at: http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfpfgcomplaint071012.pdf (alleging a failure to maintain adequate customer funds in segregated accounts and resulted in a shortfall that exceeded $200 million).

> encourages the Commission to continue re-examining the protections available to participants in the futures market by holding one or more roundtables to assess whether further protections of the collateral of futures customers are appropriate. In addition, MFA requests that the Commission repeal Commission Staff Segregation Interpretation 10-1 ("**Interp. 10-1**")[6] for futures to allow futures customers the option to safeguard their assets by using third-party custodial accounts to maintain their collateral remotely from their FCM counterparties.

D. Rulemaking Proposals on Position Limits

MFA members rely on fair, competitive, and transparent markets that respond to fundamental market factors to conduct their businesses. Accordingly, MFA members are concerned with the impact the Commission's new position limits regime will have on them and their investors. In Section V of this letter, we provide a number of comments and recommendations with respect to the Commission's Position Limits Proposal[7] and Aggregation Limits Proposal.[8]

II. MFA Priority Swaps Issues and Requests

A. Impartial Access to SEFs and SEF Implementation Concerns

1. Rulebooks

MFA respectfully requests that the Commission prioritize the staff's substantive review of SEF rulebooks and SEFs' compliance with core principles to remove remaining practical impediments to the buy-side's impartial access to SEFs. SEFs vary in their willingness to open access to the buy-side. To date, SEF rulebooks, user agreements, and practices vary considerably as to their consistency with Commission regulations and guidance. Such Commission regulations and guidance include: (1) the Commission's final straight-through processing ("**STP**") rules;[9] the final SEF rules;[10] the staff's STP guidance;[11] the staff's No-

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[6] Division of Clearing and Intermediary Oversight Amendment of Interpretation to the Financial and Segregation Interpretation No. 10 on the Treatment of Funds Deposited in Safekeeping Accounts, 70 Fed. Reg. 24768 (May 11, 2005), available at: http://www.gpo.gov/fdsys/pkg/FR-2005-05-11/pdf/05-9386.pdf.

[7] Position Limits for Derivatives, 78 Fed. Reg. 75680 (proposed Dec. 12, 2013); Extension of comment periods, 79 Fed. Reg. 37973 (July 3, 2014).

[8] Aggregation of Positions, 78 Fed. Reg. 68946 (proposed Nov. 15, 2013); Extension of comment periods, 79 Fed. Reg. 37973 (July 3, 2014).

[9] *See* Commission Final Rules on "Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management", 77 Fed. Reg. 21307 (Apr. 9, 2012), available at: http://www.gpo.gov/fdsys/pkg/FR-2012-04-09/pdf/2012-7477.pdf (the "**Final STP Rules**").

[10] *See* Commission Final Rule on "Core Principles and Other Requirements for Swap Execution Facilities", 78 Fed. Reg. 33476 (June 4, 2013) (the "**SEF Core Principles Rule**"), available at: http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-12242a.pdf.

[11] *See* "Staff Guidance on Swaps Straight-Through Processing", issued Sept. 26, 2013 (the "**STP Guidance**").

Action Letter 13-66;[12] and the Impartial Access Guidance (collectively, the "**CFTC SEF Legal Standards**"). We believe that inconsistencies with the CFTC SEF Legal Standards are due, in part, to the Commission's granting temporary SEF registration based only on a completeness review of SEF application documentation, pending the completion of the Commission's substantive review of such documentation.[13] While some SEFs have revised their rulebooks and other documentation in response to the Commission's guidance, MFA members continue to see non-compliant provisions in SEF rulebooks and other documentation, including certain aspects of SEF trading protocols that are not reflected in SEF rulebooks. Such provisions competitively disadvantage the buy-side and impede the buy-side's impartial access to direct participation on SEFs.

While we understand and acknowledge that the staff is undertaking an ongoing review of SEF rulebooks during the two-year period of temporary SEF registration, a number of buy-side firms had to adhere to SEF rulebooks with provisions that we believe are inconsistent with the CFTC SEF Legal Standards to comply with the trade execution requirement for swaps that have been "made available to trade" ("**MAT**").

Based on our members' SEF trading experiences to date, we summarize below a number of implicit and explicit barriers to the buy-side's impartial access to SEFs. We respectfully urge you to direct the staff to address and enforce removal of such barriers to access in the staff's substantive review of rulebooks for full SEF registration.

Currently, a two-tier market persists, with inter-dealer ("**IDB**") trading occurring on legacy IDB SEFs to the exclusion of most buy-side firms and dealer-to-client trading on the dominant dealer-to-client platforms. There are a number of reasons why the Dodd-Frank Act goal of an "all-to-all" market has yet to emerge:

- Certain SEFs have pricing schemes that bar access to many buy-side firms, as pricing is only viable and affordable for certain firms to access such SEFs.

- Pre-trade credit checks are a prerequisite to client clearing as they remove the need for a blanket clearing guarantee. However, the operational capabilities of SEFs to enable pre-trade credit checks have varied. More specifically, some SEFs required a Participant on the SEF to represent either that it is self-clearing, or that the Participant's clearing FCM unconditionally guarantees all of the Participant's trades. Only a dealer participant can make such a representation since: (1) while certain dealers are self-clearing, no buy-side firms are in such a position; and (2) FCMs do not provide unconditional clearing guarantees to buy-side clearing customers.

[12] *See* CFTC Staff No-Action Letter No. 13-66, "Time-Limited No-Action Relief for Swap Execution Facilities from Compliance with Certain Requirements of Commission Regulation 37.9(a)(2) and 37.203(a)", issued Oct. 25, 2013 ("**NAL 13-66**").

[13] The Commission noted in its final SEF rule that "it will review a SEF applicant's Form SEF to ensure that it is complete, and will not conduct any substantive review of the form before granting or denying temporary registration". *See* SEF Core Principles Rule at 33487.

Therefore, such a requirement will exclude buy-side participants from gaining access to the platform.

- Post-trade name disclosure by IDB SEFs violates anonymity, acting as an implicit barrier to buy-side access. Order book trade execution should remain anonymous throughout the trade cycle for all participants on such SEFs. Post-trade name disclosure comprises a buy-side firm's ability to trade on an otherwise anonymous trading platform as it: (1) reveals proprietary trading strategies; and (2) risks potential retaliation by liquidity providers in the still prevalent dealer-to-customer market.

- Delays in post-trade submission of executed trades to derivatives clearing organizations ("**DCOs**") due to the continued use of middleware and associated manual post-trade affirmation processes.

- Barriers to buy-side access to SEFs in the form of burdensome oral and written recordkeeping requirements under Rule 1.35(a) (see below) act as a significant impediment to direct access by certain CFTC-registered buy-side firms, requiring them, in practice, to use intermediaries.

- Separately, we respectfully urge the CFTC to finalize dealer ownership restrictions or thresholds for SEF governance. Dealer-dominated SEFs could create conflicts of interest, essentially creating a two-tiered SEF market where most buy-side firms are restricted to trading on a few limited SEFs.

2. Package Transactions

MFA respectfully requests that the Commission further consider the appropriate timing and application of the trade execution requirement to certain Package Transactions. While MFA supported a phased implementation of the trade execution requirement that saw certain standardized and liquid Package Transactions in the interest rate asset class (*e.g.*, benchmark USD swap spreads and swap curves and butterflies comprised of MAT swaps) transition to SEF trading, we believe that neither an adequate regulatory construct nor the requisite market infrastructure has been developed by the SEFs to enable trading of other types of Package Transactions (*e.g.*, invoice spreads, swaps vs. swaptions, *etc.*). Where an appropriate regulatory construct and/or adequately developed market infrastructure is lacking, it is impossible as a practical matter for members to trade certain Package Transactions, requiring them to "unbundle" these transactions at material cost and impairment of investment and risk management strategies.

In January 2014, MFA requested no-action relief from the CFTC staff with respect to certain swaps entered into as part of Package Transactions.[14] As noted by MFA (and various other market participants), market participants were actively developing the infrastructure

14 Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to Vincent A. McGonagle, Division of Market Oversight, CFTC, January 24, 2014, available at: https://www.managedfunds.org/wp-content/uploads/2014/01/Packaged-Transactions-NAL-Final-MFA-Letter.pdf.

necessary to process certain Package Transactions as a whole through the execution-to-clearing workflow, but the infrastructure was not available at that time. For other types of Package Transactions, there are regulatory barriers to their continued execution that warrant evaluation by the Commission (*e.g.*, the trading of futures vs. swaps as a part of invoice spreads). In CFTC No-Action Letter No. 14-62, dated May 1, 2014 ("**NAL 14-62**"), the CFTC provided no-action relief to market participants in respect of certain Package Transactions, with such relief phased in between May 15, 2014 through November 15, 2014.[15] As of November 15, absent additional no-action relief, all Package Transactions will be subject to the trade execution requirement.

While MFA appreciates the CFTC staff's grant of no-action relief under NAL 14-62, we believe it has not been sufficient to avoid causing problems to the market. The relevant infrastructure is still in the process of development, and certain aspects will not likely be completed by November 15. In addition, we seek the opportunity for further engagement with the Commission to design a regulatory construct that will permit the continued execution of certain more complex Package Transactions (*e.g.*, invoice spreads, swaps vs. swaptions, and MBS basis packages) even in the absence of any SEF listing the package as a whole. In this connection, the MFA has recommended, among other potential solutions, the consideration of a futures-style Exchange for Related Position ("**EFRP**") regime for SEFs.[16]

As an interim measure, MFA supported the CFTC staff's deferral of SEF trading of liquid and standardized Package Transactions, such as swap curves and swap butterflies that comprised exclusively benchmark swaps, until June 1, 2014. However, the staff's June 1 interim deadline has proven problematic to many MFA members in respect of certain Package Transactions (where one component has been MAT and is subject to the trade execution requirement, and each of the other components is subject to a mandatory clearing requirement but is not MAT). The June 1 deadline was just one month after the staff's issuance of NAL 14-62, and while SEFs and other market participants built some infrastructure during that month to support these trades, almost two months later, it still does not function well. As a consequence, many MFA members are incurring costs in respect of such trades -- either being unable to trade at all or being forced to incur transaction costs due to the necessity of trading the package in separate parts. The prospect of meeting the November 15 deadline, and being required to trade all Package Transactions on-SEF even where some components are not yet MAT or clearable, seems problematic to many MFA members and other swap market participants, given the significant problems they are facing with trading the current, more limited set of Package Transactions.

MFA respectfully urges the Commission to consider further the question of phasing in the trade execution requirement for Package Transactions. We suggest that the Commission and staff seek input from all interested parties, including the industry, and design a regulatory construct that ensures that market participants can continue to enjoy the economic and risk transfer efficiencies that Package Transactions provide. MFA specifically requests that the

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15 *See* CFTC Staff No-Action Letter No. 14-62, dated May 1, 2014, available at: http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-62.pdf.

16 *See supra* note 14 at 6-7.

Commission consider revising the compliance timeline until critical market infrastructure for the various types of Package Transactions is completed, tested, and ready for widespread commercial use by swap market participants. We have attached a copy of MFA's letter requesting relief as Appendix A.

B. Exemption for SEF Members that are Registered CTAs/CPOs from Rule 1.35(a)'s Oral and Written Recordkeeping Requirements

MFA respectfully requests that the Commission grant an exemption for SEF members that are registered CTAs/CPOs from amended CFTC Rule 1.35(a)'s oral and written recordkeeping requirements. In response to concerns that MFA and other buy-side trade associations and market participants have raised in numerous letters and meetings with the Commission and its staff, the Commission staff has extended no-action relief for CTAs from compliance with the oral recordkeeping requirement until December 31, 2014.[17] More recently, on May 22 the Commission staff issued a no-action letter to members of SEFs and DCMs that are not registered, or required to be registered, with the Commission. The relief grants a temporary exemption from the Rule 1.35(a) written recordkeeping requirements to keep electronic text messages and to keep records in a form and manner identifiable and searchable by transaction.[18] According to the Commission's press release, the relief will remain effective until the Commission "revisits the rule to appropriately tailor the rule's requirements to the relevant entities and more carefully consider the costs and technological feasibility of compliance with the rule".[19]

Unfortunately, both no-action letters merely postpone the effective date of a recordkeeping rule whose scope and application to CTAs and CPOs should be reconsidered by the Commission. By subjecting buy-side SEF members to Rule 1.35's onerous oral taping and written recordkeeping requirements, as well as Rule 1.31's burdensome and costly electronic recordkeeping, preservation and potential third-party technical consultant requirements,[20] the combined effect of these rules acts as a barrier for them to trade directly on SEFs. Affected MFA members that are CTAs and CPOs and other buy-side firms strongly believe that these recordkeeping requirements should not apply to them, because they are not engaged in a

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[17] *See, e.g.,* Request for Interpretative Guidance and Relief on Application of Rule 1.35(a) to Asset Managers, submitted on December 10, 2013 by MFA and the Asset Management Group of the Securities Industry and Financial Markets Association ("**SIFMA AMG**"), available at: https://www.managedfunds.org/wp-content/uploads/2013/12/AMG-MFA-LETTER-on-Rule-1-35-12-10-13-final.pdf (the "**December 2013 Joint Letter**"); *see also* CFTC Staff No-Action Letter No. 14-60, issued on April 25, 2014 by the Division of Swap Dealer and Intermediary Oversight and the Division of Market Oversight, available at: http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-60.pdf.

[18] *See* CFTC No-Action Letter No. 14-72, issued on May 22, 2014 by the Division of Swap Dealer and Intermediary Oversight and the Division of Market Oversight, available at: http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-72.pdf.

[19] *See* Commission Press Release issued on May 22, 2014, available at: http://www.cftc.gov/PressRoom/PressReleases/pr6936-14.

[20] *See* Section III.B. herein for further explanation of MFA's concerns and requests with respect to Commission Rule 1.31.

"dealing" business. These buy-side firms do not "hold [themselves] out" as dealers or make a market in swaps. To be sure, CTAs and CPOs are not dealing or executing intermediaries and are thus distinguishable from all other types of intermediaries explicitly named in Rule 1.35(a) (*i.e.*, FCMs, retail foreign exchange dealers, and introducing brokers ("**IBs**")). FCMs and IBs take orders from customers in connection with trade execution, provide two-sided markets, and are paid transaction-based compensation. By contrast, CPOs and CTAs are compensated based on the value of customer assets under management and the profits generated on those assets. Thus, CPOs and CTAs have an economic incentive to obtain the best prices for orders entered on behalf of their customers.

In addition to capturing buy-side entities that do not act as dealers or executing intermediaries within its scope, Rule 1.35(a) expands the concept of membership beyond its historical scope, without adequate notice to market participants of what it means to be a "member of a SEF". Notably, the CFTC's Division of Market Oversight ("**DMO**") 2009 Advisory never mentioned CTAs, CPOs, or other customers as "members" of DCMs that must comply with recordkeeping requirements.[21] When the CFTC proposed changes to its recordkeeping rules in 2011 and finalized its rules in 2012, the CFTC had not yet determined what it meant to be a "member of a SEF". Thus, most market participants did not in advance appreciate the significance of what it would mean to be a "member of a SEF". The CFTC did not finalize its SEF rules until mid-2013. Thus, the CFTC adopted amendments to Rule 1.35(a) prior to a final determination as to which entities would be subject to Rule 1.35(a). The final SEF rules recognized a difference between members of a SEF and SEF market participants. With this distinction, most CTAs, CPOs and other asset managers did not expect that they would be considered a SEF "member". However, as SEFs began publishing their rulebooks towards the end of 2013, their rulebooks, generally, conditioned platform access on having "trading privileges". This condition created uncertainty with whether a participant with direct access to a SEF would be considered a "SEF member". Also, depending on a firm's trading structure, a firm's CTA could be designated to be the SEF "Member" rather than the firm that actually has the economic risk (*i.e.*, the commodity pool or client account).

Accordingly, many affected CTAs and CPOs have opted out of direct participation on SEFs due to the uncertainties, ambiguities, compliance challenges, and costs posed by Rule 1.35's recordkeeping requirements on SEF members. Instead, these firms prefer to use sponsored or intermediated access to SEFs for trading swaps that are subject to the trade execution requirement. Many MFA members that are CTAs are particularly concerned that the compliance costs for Rule 1.35(a)'s oral taping obligation lack sufficient justification for regulatory purposes, as substantially all conversations seeking swap quotes or providing swap

[21] *See* CFTC DMO "Advisory for Futures Commission Merchants, Introducing Brokers, and Members of a Contract Market over Compliance with Recordkeeping Requirements", issued on February 5, 2009, at 5, footnote iv (obligating FCMs, floor brokers and introducing brokers to comply with recordkeeping requirements with respect to customer transactions).

trading instructions on SEFs are currently recorded by their swap dealers and FCMs under the CFTC's recordkeeping requirements, including Rule 1.35(a).[22]

For MFA members that prefer direct SEF participation for their trading strategies, any implicit barrier in the form of burdensome oral and written recordkeeping requirements under Rule 1.35(a) acts as an impediment to their direct access. As a result, application of Rule 1.35(a) to such firms would arguably undermine the statutory reform goals of Section 733 of the Dodd-Frank Act to promote SEF trading and pre-trade transparency in the swaps market. Therefore, MFA respectfully requests that the Commission reconsider the appropriate scope of Rule 1.35(a), and grant an exemption from the oral and written recordkeeping requirements for registered CTAs and CPOs that are treated as SEF members. We have attached a copy of MFA's joint letter with SIFMA AMG requesting interpretative guidance and relief as Appendix B.

C. Swap Data Reporting Issues

MFA respectfully requests that the Commission prioritize improvements to its swap data reporting regime to support the transparency goals of the Dodd-Frank Act. As Commissioners and staff have noted publicly, the current regime is essentially not producing useful data for either regulators or market participants.[23] On May 27, MFA and the Alternative Investment Management Association ("**AIMA"**) submitted a joint comment letter to the Commission on its swap data reporting rules.[24] In the letter, MFA and AIMA responded to specific questions in the Commission's comment release to assist the Commission in improving and refining the swap data reporting regime. Our goal is to assist the Commission in improving and re-launching its swap data reporting regime so that swap data repositories ("**SDRs**") collect and make available meaningful data for regulators and for the marketplace as a whole. Following is a list of our main responses and recommendations in order of priority:

- <u>Alpha Swap Reporting of Swaps Intended to be Cleared ("**ITBC Swaps**")</u>: To reduce the submission of unusable data, we recommend eliminating the reporting of an

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22 *See also* SIFMA AMG letter re: CFTC Staff Roundtable to Discuss Dodd-Frank End-User Issues and Request for Interpretative Guidance and Relief on Application of Rule 1.35(a) to Asset Managers, filed with the CFTC on April 17, 2014, at 4 ("We believe that substantially all Covered Conversations [*i.e*., those regarding swap quotes and trading on SEFs and those regarding block trades executed pursuant to SEF rules] are currently taped by Dealers and FCMs, and we expect that status quo to continue into the foreseeable future."). This letter also renewed the prior request of MFA and SIFMA AMG in the December 2013 Joint Letter to exempt asset managers that are members of SEFs or DCMs from the oral and written recordkeeping requirements of Rule 1.35(a). *See supra* note 17.

23 *See, e.g.,* Joint Release, "CFTC, OFR Sign Memorandum of Understanding to Improve Data Quality," issued March 31, 2014, available at: http://www.cftc.gov/PressRoom/PressReleases/pr6899-14; *see also* Keynote Address by Commissioner Scott D. O'Malia, State of the Industry 2014 Conference, Commodity Markets Council, "We Can Do Better: It's Time to Review Our Rules and Make Necessary Changes," January 27, 2014, available at: http://www.cftc.gov/PressRoom/SpeechesTestimony/opaomalia-32.

24 *See* MFA-AIMA letter in response to the Commission's "Review of Swap Data Recordkeeping and Reporting Requirements" (RIN 3038-AE12), available at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59872.

original "alpha" swap for any swap that is executed with the intention to be cleared, or ITBC Swap. Our position is based on the fact that under the Final STP Rules[25] and existing market practices, ITBC Swaps are submitted and accepted for clearing immediately. The alpha and beta/gamma swap reporting paradigm was based on a legacy novation-based clearing model that no longer exists for ITBC Swaps. Further, with respect to ITBC Swaps executed on SEFs or DCMs, based on the STP Guidance[26] and SEF rules, if the DCO rejects a SEF-executed ITBC Swap from clearing, the ITBC Swap is *void ab initio*.[27] Thus, there is no actual alpha swap that arises when a DCO rejects a SEF-executed ITBC Swap from clearing. For ITBC Swaps subject to the Commission's clearing mandate but not executed on SEFs, given the clearing requirement, the swap cannot exist as an uncleared swap. Thus, there is either a cleared swap (*i.e.,* beta and gamma) or no swap at all.

- <u>Valuation Data</u>: To reduce duplicative reporting, DCOs should be the only entities required to report valuation data for cleared swaps to SDRs. We do not believe that the Reporting Rules should require swap dealers, major swap participants, or any other reporting counterparty to provide valuation data for cleared swaps to SDRs. CFTC regulation 45.4(b)(2)(i) already requires the DCO to report valuation data to the SDR on a daily basis. We believe it is neither necessary nor desirable for an SDR to receive this information from two separate sources.

- <u>Reporting Package Transactions</u>: With respect to SDR reporting under Part 45, we suggest reporting package transactions at the individual component level. However, we believe real-time public dissemination of swap market data under Part 43 should reflect the actual economic transactions that took place and the pricing of those transactions at the package (vs. component) level. This reporting recommendation is consistent with how the individual swap legs are cleared and maintained at the DCO, as well as with how continuation data, including ongoing valuation data, will be reported.

- <u>Reporting Party Status Change</u>: The Commission should provide a reasonable phase-in period for compliance with the reporting counterparty obligations after the date of the applicable status change for any buy-side firm to assume reporting counterparty obligations. We understand that the intent of the Commission is to have the swap dealers and major swap participants bear the reporting responsibility, given their larger role in the marketplace. Rather than requiring dual reporting, this approach has promoted efficiency and laid the foundation for a more accurate data regime. The market has embraced this approach, but there can be instances where changes in dealer structures can create buy-side reporting obligations. To avoid potential interruptions and inaccuracies in reporting to an SDR, the Commission should require

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25 *See supra* note 9.

26 *See supra* note 11.

27 *Id.* at 5.

a CFTC-registered swap dealer affiliate of a de-registered swap dealer to assume the reporting counterparty obligations, when applicable.

- Reporting Collateral Information for Consistency with EU Rules: We urge the Commission not to import the European Union's **("EU")** collateral information reporting requirement into the Commission's final rules on real-time public reporting and SDR reporting (together, the "**Reporting Rules**"). The infrastructure of many market participants, particularly buy-side firms, does not readily support complex collateral reporting requirements required by EU reporting rules, such as the reporting of collateral on a portfolio basis, and the incremental benefit to regulators has not been demonstrated. We respectfully urge the Commission to address existing the U.S. swap data reporting concerns before considering any new requirements, and carefully to consider the benefit of additional reporting before expanding the current regime.

- Bespoke Swaps: We urge the Commission to monitor the development of standard industry trade representations for bespoke, exotic, or complex swaps, and to work with relevant industry bodies to ensure that data fields for such products are amenable to standardization, relevant for regulatory purposes, and workable for reporting counterparties to comply with the Reporting Rules.

- Confirmation Data: We recommend that confirmation data reported to SDRs should include standardized data fields that represent the customary economic data elements of swaps in each asset class. The original launch of the Commission's swap data reporting regime had undue complexity and lack of uniformity across platforms. As the Commission looks to re-launch the regime, we recommend that confirmation data reported to SDRs only should include standardized data fields that represent the customary economic data elements of swaps in each asset class. Reported confirmation data should not incorporate terms by reference, such as from the International Swaps and Derivatives Association, Inc. ("**ISDA**") Master Agreement provisions and ISDA definitions, which contain privately negotiated modifications in the related Schedules and Credit Support Annexes, with further modifications in the final agreed terms for particular swaps. Reporting of such negotiated terms to SDRs as confirmation data would introduce unnecessary complexities and operational challenges for achieving the requisite data consistency, harmonization, and accessibility for regulatory purposes.

We discussed our responses and recommendations in greater detail in a meeting with Commission staff on July 17, 2014.

C. Cross-Border Issues

MFA appreciates the coordination by the Commission with its U.S., European and other non-U.S. counterparts as policymakers and regulators in the different jurisdictions adopt and implement their respective derivatives reforms. In particular, we appreciate the agreement between the Commission and the European Commission ("**EC**") on a "common path forward" on regulation of cross-border swaps,[28] and the OTC Derivatives Regulators similar understanding on cross-border implementation.[29] We think both of these agreements reflect positive collaboration.

MFA encourages the Commission to continue such coordination to ensure that derivatives regulatory reforms implemented in the U.S. and other jurisdictions are consistent, where applicable, and address counterparty and systemic risk, while permitting access to, and competition among, CCPs. We also request that the Commission and other U.S. and non-U.S. regulators harmonize the extraterritorial scope and substituted compliance frameworks of their derivatives regulatory regimes. The extraterritorial application of U.S. and non-U.S. derivatives regulations (particularly EMIR) remains a significant area of focus and concern for MFA. Unfortunately, considerable uncertainty continues to exist with regard to this issue.

In particular, MFA highlights below two regulatory areas in respect of the Dodd-Frank Act and EMIR where it is critical that the Commission, and other U.S. and European policy makers and regulators reach a prompt resolution to ensure the continued robustness of the derivatives markets.

1. Recognition of Third Country CCPs

MFA emphasizes that it is critical to ensure that derivatives regulatory reforms in the U.S. and other jurisdictions permit access to, and competition among, CCPs. In particular, it is important that approval by the Commission and other U.S. and non-U.S. regulators of CCPs organized outside their jurisdiction (*i.e.*, third country CCPs) not become unreasonably difficult to obtain nor discriminate in terms of the treatment of customer or proprietary accounts.

As discussed further below, many entities subject to the Commission's swap rules enter into swaps with entities subject to EMIR or equivalent regulations in other jurisdictions. As the various jurisdictions implement mandatory clearing, such cross-border swap transactions may become subject to duplicative or conflicting clearing obligations. For example, where a U.S. entity is required to clear swaps subject to Commission rules and its counterparty is required to clear swaps subject to EMIR, then only if the requirements of the two regimes are not in conflict would clearing the trade be possible.[30] Therefore, one necessary component of resolving any potential conflicts between the two clearing obligations is for the Commission to recognize third country CCPs, and thus, permit the U.S. entity to clear through the same CCP that its non-U.S. counterparty is permitted to clear through for purposes of EMIR.

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[28] *See* Commission Memo "The European Commission and the CFTC reach a Common Path Forward on Derivatives", July 11, 2013, available at: http://europa.eu/rapid/press-release_MEMO-13-682_en.htm?locale=en; and CFTC press release, "The European Commission and the CFTC reach a Common Path Forward on Derivatives", July 11, 2013, available at: http://www.cftc.gov/PressRoom/PressReleases/pr6640-13.

[29] *See* OTC Derivatives Regulators Group "Report on Agreed Understandings to Resolving Cross-Border Conflicts, Inconsistencies, Gapes and Duplicative Requirements" (August 30, 2013), available at: http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/odrgreport.pdf.

[30] Although we recognize that the Commission and other regulators will issue various substituted compliance or equivalence determinations, the scope and timing of those determinations remain unknown.

Because of the widespread, global implementation of mandatory clearing, recognition of such third country CCPs is important to ensure that market participants have sufficient access to, availability of, and competition among, CCPs organized in U.S. and non-U.S. jurisdictions. Otherwise, there is potential that the derivatives market will become fragmented along jurisdictional lines, which could significantly harm the markets by, among other things, impeding competition, impairing portability, limiting participant access to clearing, and ultimately creating artificial barriers across a global marketplace and instrument type. Thus, we ask the Commission to approve promptly CCPs organized in equivalent third countries to facilitate and encourage cross-border trading of cleared swaps.

2. Regulatory Conflicts Due to Application of Article 13 of EMIR

A key issue remains outstanding with respect to Article 13 of EMIR and the EC's adoption of an implementing act on equivalence in respect of the U.S. Specifically, Article 13 of EMIR permits the EC to declare the rules of a third country (*e.g.*, the U.S.) to be "equivalent" to the relevant provisions of EMIR.[31] Following an EC declaration of equivalence with respect to a third country's rules, Article 13 provides that where an EU entity is trading with a counterparty that is "established" in that third country, then the EU counterparty will be deemed to be in compliance with EMIR if it is complying with the third country's equivalent rules.

The notion of being "established" in a jurisdiction and the related equivalence determinations presents difficulties for the U.S. fund industry and their EU counterparties. Many alternative investment funds ("**AIFs**") are legally incorporated outside the United States in jurisdictions that may not have rules equivalent to EMIR (*e.g.*, in the Cayman Islands). However, because these AIFs are managed by U.S.-based investment managers or are majority-owned by U.S. persons, for purposes of the Commission's final interpretive guidance,[32] these AIFs are deemed to be US persons ("**U.S. AIFs**") and are subject to the Commission's swap regulations, including reporting, clearing, margin requirements, and segregation of collateral.

In addition, frequently, these U.S. AIFs will enter into swaps with a counterparty established in the EU that is subject to regulation under EMIR as a "financial counterparty" and that may or may not be a "swap dealer" within the meaning of the Commission's final entity definitions ("**EU Bank**").[33] Because these U.S. AIFs are subject to Commission swap rules and the EU Bank is subject to EMIR, if the EC does not regard these U.S. AIFs as being

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[31] These areas of EMIR for which equivalence is permitted include the clearing obligation, the reporting obligation, non-financial counterparties, and risk mitigation techniques for OTC derivative contracts not cleared by a CCP.

[32] *See* Commission final "Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations", 78 Fed. Reg. 45292 (July 26, 2013), available at: http://www.gpo.gov/fdsys/pkg/FR-2013-07-26/pdf/2013-17958.pdf ("**Final Guidance**") (setting forth a definition of "U.S. person" and its application to cross-border swap activities).

[33] *See* Commission and SEC joint final rule; joint interim final rule; interpretations on "Further Definition of 'Swap Dealer,' 'Security-Based Swap Dealer,' 'Major Swap Participant,' 'Major Security-Based Swap Participant' and 'Eligible Contract Participant'", 77 Fed. Reg. 30596 (May 23, 2012), available at: http://www.gpo.gov/fdsys/pkg/FR-2012-05-23/pdf/2012-10562.pdf.

"established" in the U.S. for purposes of Article 13, then both the AIF and its EU counterparty would need to comply with both the Commission's rules and EMIR. This duplicative regulation would occur despite the fact that the purpose of Article 13 and the Commission's substituted compliance regime is to prevent counterparties from having to comply with two separate and equivalent regulatory regimes and all of the difficulties that such compliance would entail.

MFA emphasizes that this fact pattern is reflective of a significant volume of business in the EU derivatives market. Therefore, this issue should not be underestimated and could have serious consequences on the business of EU Banks and U.S. AIFs as they may cease transacting with each other in order to avoid duplicative or conflicting rules. Such an outcome would be contrary to the interests of global trading as well as ease of access to markets. Therefore, we would appreciate it if, as the Commission engages with EU policy makers and regulators on cross-border issues, it could focus on resolving this matter in a reasonable and equitable manner. We have attached a copy of MFA's discussion paper on this matter as Appendix C.

III. Regulation of Commodity Pool Operators and Commodity Trading Advisors

As a result of the statutory changes from the Dodd-Frank Act, redefining a "swap" as a commodity interest and subject to the Commission's jurisdiction, and the Commission's 2012 decision to rescind CFTC Regulation 4.13(a)(4),[34] an exemption from registration for operators of privately-offered commodity pools, several hundred investment managers overseeing several thousand funds became registered with the CFTC as CPOs and/or CTAs. Notwithstanding that many of these entities had been operating for many years in accordance with other regulatory structures on the local, federal and global level (*e.g.*, SEC, Cayman Islands Monetary Authority, British Virgin Islands Financial Services Commission, UK Financial Conduct Authority, Hong Kong Securities and Futures Commission, etc.), they found that as a result of these changes, they had to register with the Commission as CPOs and/or CTAs. In certain instances, their business or operational structures may not match or meet the specific requirements of the Commission's regulatory framework. We do not seek to have the Commission restore Regulation 4.13(a)(4). Instead, MFA has worked with staff to facilitate compliance. Accordingly, MFA, along with other associations, law firms, consulting firms, and individuals, have sought relief and guidance for CPOs and CTAs where there have been discrepancies or uncertainty with respect to compliance with Commission regulations, as have other associations, legal and consulting firms, and individuals.

The Division of Swap Dealer and Intermediary Oversight staff ("**DSIO Staff**") has addressed some issues through frequently-asked-questions and no-action relief. There are many outstanding regulatory issues, however, for newly-registered and exempt CPOs and CTAs that operate/advise non-traditional commodity pools (*e.g.*, hedge funds, fund-of-funds, private equity

[34] CFTC Final Rule on Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, 77 *Fed. Reg.* 11252 (Feb. 24, 2012) (herein, "**Final Rule Release on CPO and CTA Compliance Obligations**"), available at: http://www.gpo.gov/fdsys/pkg/FR-2012-02-24/pdf/2012-3390.pdf. CFTC Regulation 4.13(a)(4) provided an exemption from registration for operators of pools that are offered only to individuals and entities that satisfy the qualified eligible person standard under CFTC Regulation 4.7 or the accredited investor standard under the SEC's Regulation D.

funds, real estate investment trusts and securitizations) and are subject to different legal and regulatory regimes. Many of these new or newly registered CPOs and CTAs are finding that aspects of the Commission's part 4 regulations are very burdensome, create confusion for investors, and do not make sense with respect to their business models. We estimate that the industry is spending tens of millions of dollars each year on legal and compliance costs to address or resolve regulatory discrepancies and ambiguities. At the same time, we understand that the large number of requests for relief and guidance places a huge strain on the Commission's limited resources.[35] We believe to conserve on Commission and registrant resources and to ensure consistency in regulation, the Commission should consider rulemaking or more comprehensive relief in a few areas that impact broad groups of registrants as discussed and explained below. In this way, the Commission will most effectively use its resources and provide the greatest amount of relief to registrants.

A. Delegation of CPO Obligations

MFA respectfully requests that the Commission engage in rulemaking to address "CPO Delegation" and provide interim relief, as explained. MFA appreciates the DSIO Staff's efforts in creating a streamlined, expedited no-action relief process for seeking no-action relief from registration as a CPO under Section 4m(1) of the Commodity Exchange Act ("**CEA**") where another person would serve in lieu thereof as the registered CPO of a commodity pool (referenced herein as "**CPO Delegation**").[36] While we have been working with DSIO Staff in seeking clarifications on CFTC Staff No-Action Letter 14-69 **(**"**NAL 14-69**"**)** to allow a greater number of registrants to make use of the expedited no-action relief process, many registrants will still need to file bespoke no-action letters as their circumstances differ from those set forth in NAL 14-69. We believe rulemaking is necessary to address the widespread industry need for CPO Delegation relief due to the nature of common investment fund structures, and to provide legal consistency on this matter with respect to corporate entities of public and private funds.[37] In the interim, we believe the Commission should provide omnibus industry relief on CPO Delegation and establish a process by which a person may claim relief.[38]

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35 We also understand that many registrants have submitted requests for no-action relief and continue to await relief, many months after-the-fact.

36 CFTC Staff Letter No. 14-69, May 12, 2014, available at: http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-69.pdf. CFTC Staff Letter 14-69 maintains that the letter does not provide relief, but establishes circumstances under which the DSIO Staff would grant a person expedited no-action relief. MFA had been in discussions with DSIO Staff on CPO Delegation since the beginning of 2012, explaining the prevalence of the need for relief and urging DSIO Staff to provide omnibus industry relief.

37 In this letter, we use the term "fund" or "investment fund" synonymously with "pool" and "commodity pool".

38 *See, e.g.*, CFTC Staff Letter 12-03, July 10, 2012 (providing certain CPOs with additional time to become compliant with CFTC regulations and establishing a process to claim such relief), available at: http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-03.pdf; CFTC Staff Letter 12-38, November 29, 2012 (providing certain operators of fund-of-funds with a delayed CPO registration compliance date and establishing a process to claim such relief), available at: http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-38.pdf; *and* CFTC Staff Letter 12-40,

The CPO Delegation issue came to the forefront in 2013 as many CPOs of private investment funds became registered with the Commission as a result of the rescission of CFTC Regulation 4.13(a)(4). Also, previously, it had not been clear to investment managers that DSIO Staff takes the view, for example, that:

- In the case where a fund is structured as a limited partnership and has multiple general partners, that each general partner, besides the general partner registered and serving as the fund's CPO, may be deemed a CPO of the fund and obligated to register or seek CPO Delegation no-action relief; and

- In the case where a fund is structured as a corporation, trust, or limited liability company governed by a board of directors, that each director may be deemed a CPO and obligated to register or seek CPO Delegation no-action relief, even where the fund has entered into a contractual arrangement with a registered CPO.

As investment fund complexes are typically structured as limited partnerships, corporations, trusts, limited liability companies, or other similar corporate entities, the need for CPO Delegation relief is commonplace. The DSIO Staff's streamlined process and criteria for seeking expedited no-action relief do not address all of the structural variations and circumstances that exist for fund complexes. It is burdensome and costly for the Commission and registrants to require each fund complex that does not meet the exact criteria set forth in NAL 14-69 to separately retain counsel and apply for individual no-action relief. We understand that it is burdensome on DSIO Staff as well, and that DSIO Staff is receiving about 50 standardized requests for relief a week, not including bespoke requests for no-action relief from persons with different facts and circumstances than those set forth in NAL 14-69. On July 15, 2014, MFA submitted a request to DSIO Staff for clarifications to NAL 14-69 that would allow affiliated directors of a commodity pool to use the expedited relief process.[39] Nonetheless, for administrative, resource and regulatory efficiency, we believe the Commission needs to address CPO Delegation through rulemaking. Rulemaking would enable the Commission comprehensively to address CPO Delegation, registration and oversight issues on a policy basis, rather than through specific facts and circumstances. As you may know, one of the strengths of the investment fund industry is that it is diverse and highly entrepreneurial. Having DSIO Staff

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December 4, 2012 (providing certain operators of a business development company with relief from CPO registration and establishing a process to claim such relief), available at: http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-40.pdf. In these and many other instances, the Commission has provided groups of similarly-situated persons with relief through the issuance of an industry no-action letter and requiring persons to claim relief by filing certain information with the Commission.

[39] *See* letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to Gary Barnett, Director, CFTC, dated July 15, 2014, available at: https://www.managedfunds.org/wp-content/uploads/2014/07/MFA-CPO-Delegation-Follow-up-to-Letter-14-69.final_.7.15.14.pdf. MFA is concerned that without DSIO Staff clarification on CFTC Staff Letter 14-69, many investment funds may have difficulty retaining knowledgeable and talented affiliated directors or may need to file bespoke requests on behalf of affiliated directors for CPO Delegation relief. Even with relief, however, many investment funds may still have difficulty retaining knowledgeable and talented affiliated directors as CFTC Staff Letter 14-69 treats affiliated directors and independent directors differently by requiring affiliated directors to agree to joint and several liability with the Designated CPO, as defined in the letter.

address CPO Delegation on a facts and circumstances basis, however, would not be an effective use of the Commission's resources, and would continue to create great regulatory uncertainty for persons seeking relief, investment funds and their investors.

Moreover, we believe, for legal consistency and equality, the Commission should treat directors of a private investment fund the same as directors of a public investment fund. The Commission's Final Rule Release on CPO and CTA Compliance Obligations states that "to require a member or members of the registered investment company's board of directors to register would raise operational concerns for the registered investment company as it would result in piercing the limitation on liability for actions undertaken in the capacity of director."[40] Such rationale applies equally with respect to a member or members of a private investment fund's board of directors. We are concerned that DSIO Staff's current position with respect to directors of a private investment fund subjects directors to personal financial liability for actions undertaken in the capacity of director. This position has serious implications for chilling the ability of a private investment fund to retain knowledgeable, experienced, and talented directors, including affiliated directors, and is contrary to the interests of fund investors. In our view, members of a fund's board of directors should be considered as agents to the fund, akin to employees of a CPO.

Accordingly, we respectfully urge the Commission to engage in rulemaking with respect to CPO Delegation and to provide the industry with interim relief and establish a process through which persons could claim such relief. Interim relief would provide applicants certainty of timing and process, and allow such persons to focus fully on their business obligations.

B. CPO/CTA Recordkeeping Requirements

MFA respectfully urges the Commission to consider rulemaking and temporary time-limited no-action relief in response to our petition on CPO and CTA recordkeeping rules. MFA, jointly with the Investment Adviser Association and the Alternative Investment Management Association, submitted a petition to the Commission on July 22, 2014 to amend (the "**Petition**"): (1) CFTC Regulation 1.31, which in part sets forth electronic recordkeeping and third-party technical consultant requirements; (2) CFTC Regulations 4.7(b) and (c), which in part set forth recordkeeping requirements applicable to those registrants relying upon such exemptions; (3) CFTC Regulation 4.23, which sets forth recordkeeping requirements generally applicable to CPOs; and (4) CFTC Regulation 4.33, which sets forth recordkeeping requirements generally applicable to CTAs.

New CPO and CTA registrants are finding technical compliance with the Commission's recordkeeping regulations unduly burdensome and costly due to the regulations' incorporation of outdated technology and incongruity with standard market practices, particularly with respect to electronic recordkeeping and third-party recordkeepers. For example, Regulation 1.31 requires that electronic records be kept in their native (or original) format; be preserved in a "non-

[40] *See* Final Rule Release on CPO and CTA Compliance Obligations, *supra* note 34 at 11259. Accordingly, with respect to public investment funds/companies, because the CFTC does not view directors to such a fund as CPOs, they are not under an obligation to register or seek CPO Delegation no-action relief.

rewritable, non-erasable format;" and that firms that maintain electronic recordkeeping retain a third-party technical consultant who has access to, and the ability to download, the firm's electronic records. The relevant provisions in CFTC Regulation 1.31 were adopted in 1999,[41] at the cusp of the age of electronic records, and the regulation requires firms either to remain suspended in time by using obsolete technology or to duplicate recordkeeping efforts to meet modern business needs in addition to outdated recordkeeping requirements. Indeed, when the Commission adopted the relevant electronic recordkeeping provisions of Regulation 1.31, it noted that "the pace of technological changes will require the Commission continually to review the standards articulated in this rule to ensure that the recordkeeping requirements reflect to the extent possible the reality of established technological innovation."[42]

The technical compliance aspects of Regulation 1.31 are out of step with modern industry standards and present significant challenges to a firm trying to maintain a robust disaster recovery/business continuity plan program. Strict adherence to Regulation 1.31 now links a firm's survival of a disaster to physical access to the storage location housing the physical back-up media – this is a model that a series of natural disasters, utility grid failures, and terroristic attacks have demonstrated is flawed.

In addition, firms must retain and train a third-party technical consultant, rather than rely upon existing staff that already has expertise with and access to required records. In the "new world" of electronic storage of the 1990s and 2000s when technical expertise was uncommon, this requirement may have made sense. However, in today's world, with sophisticated NFA, CFTC, and even SEC examination personnel and programs, robust retention systems, and very intrusive investor due diligence, such an expense would be wasteful and of little value.

Finally, the Petition requests that the Commission amend its regulations to permit a CPO to utilize any third-party service provider with respect to maintaining records. Under our proposed framework, a CPO would retain responsibility for compliance with recordkeeping. We request that the Commission make the respective regulatory amendments for CTAs as well.

Accordingly, as set forth in the Petition, we respectfully request that the Commission amend CPO and CTA recordkeeping regulations to be more flexible and less prescriptive with respect to technical compliance and to provide time-limited no-action relief. We have attached a copy of the Petition as Appendix D.

C. CFTC/SEC Harmonization Issues

MFA respectfully requests that the Commission engage in rulemaking to harmonize CFTC regulations for CPOs and CTAs with SEC regulations with respect to investment advisers

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[41] Recordkeeping: Storing Records: SEC & CFTC Harmonization, 64 Fed. Reg. 28735, at 28735 (May 27, 1999) (hereinafter, the "**1999 Recordkeeping Release**").

[42] *Id.* The 1999 Recordkeeping Release went on to state that: "The Commission therefore welcomes consultation with industry participants and specific proposals regarding how the regulations might be amended in the future to permit the futures industry to use available technology and to respond to the Commission's legitimate needs to have access to complete and accurate records when necessary."

and private placements. Many of the CFTC's new CPO and/or CTA registrants are SEC-registered investment advisers that offer privately placed investment funds/commodity pools. These registrants are finding the discrepancies between the CFTC's and SEC's regulations unduly burdensome. Just as the Commission issued final rulemaking in August 2013 on "harmonization of compliance obligations for registered investment companies required to register as commodity pool operators",[43] we believe the Commission should harmonize regulations for registered investment advisers of privately offered investment companies/commodity pools required to register as CPOs and/or CTAs. This request would also be in line with prior requests from President Obama's administration for the CFTC and SEC to harmonize futures and securities regulations.[44] We highlight a few areas below where we respectfully request that the Commission engage in harmonization with SEC regulations.

1. JOBS Act Equivalence

MFA respectfully urges the Commission to amend CFTC Regulations 4.7 and 4.13(a)(3) per our petition to the Commission dated July 17, 2012 (the "**Private Offerings Petition**")[45] to be consistent with changes in the securities laws and regulations with respect to private offerings. Title II, Access to Capital for Job Creators, of the JOBS Act amends the securities laws and regulations by eliminating the prohibition on general solicitation or advertising in connection with the non-public offering of securities under Rule 506 under the Securities Act of 1933 (the "**Securities Act**"). The JOBS Act mandates consistent treatment of Regulation D Rule 506 offerings across the federal securities laws. It does not, however, specifically mandate harmonizing changes to the Commission's part 4 regulations, which creates an inconsistency between the amended Regulation D and Regulations 4.7(b) and 4.13(a)(3)—the Commission's regulations pertaining to privately-offered commodity pools.[46]

As discussed in the Private Offerings Petition, when the Commission adopted Regulations 4.7(b) and 4.13(a)(3), it ensured that the rules were consistent with the federal securities laws and regulations. We believe the Commission's regulations should be consistent with the JOBS Act and continue to be consistent with the Regulation D framework for non-

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43 78 Fed. Reg. 52308 (Aug. 22, 2013).

44 *See, e.g.,* U.S. Department of Treasury, Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation (June 17, 2009), available at: *http://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf*.

45 Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to David A. Stawick, Secretary, CFTC dated July 17, 2012 on "Harmonization of Compliance Obligations and The Jumpstart Our Business Startups Act and CFTC Regulations," available at: https://www.managedfunds.org/wp-content/uploads/2012/07/CFTC-JOBS-Act-final-7-17-12.pdf.

46 Hedge funds, including commodity pools, generally rely on the safe harbor for private offerings found in Regulation D under the Securities Act. Rule 502(c) of Regulation D precludes an issuer from offering or selling its securities by any form of general solicitation or general advertising. CFTC Regulation 4.7(b) provides an exemption from certain part 4 requirements for CPOs with respect to offerings to qualified eligible persons. CFTC Regulation 4.13(a)(3) provides an exemption from CPO registration where commodity interest trading is limited and pool participants are sophisticated. Many hedge funds/commodity pools rely on Rule 506 of Regulation D (which incorporates the requirements of Rule 502) and either Regulation 4.7(b) or Regulation 4.13(a)(3).

public offerings of private investment funds; and respectfully urge the Commission to amend Regulations 4.7(b) and 4.13(a)(3). We have attached a copy of our Private Offerings Petition as Appendix E.

2. Quarterly Reports and Audited Financial Statements

We respectfully request that the Commission provide relief or amend Regulations 4.7(b)(2) and 4.22(f)(2) to provide operators of fund-of-funds and private investment funds with hard-to-value or illiquid assets with sufficient time to prepare and distribute quarterly statements; and operators of privately-offered commodity pools with sufficient time to prepare and distribute audited financial statements. As a result of the Commission's rescission of Regulation 4.13(a)(4), and the Commission's position that "a fund investing in an unaffiliated commodity pool is itself a commodity pool",[47] many CPOs of fund-of-funds and investment funds have or may need to register with the Commission.[48] We are concerned that the Commission's reporting requirements do not contemplate funds-of-funds or other circumstances where a fund may have investments in hard-to-value or illiquid assets and cannot meet the Regulation 4.7(b)(2) requirement to distribute a periodic report within 30 calendar days after the end of the reporting period. Without a general streamlined regulatory process, it is burdensome and costly for registrants to apply individually for no-action relief.

Privately-offered funds do not have a periodic reporting requirement under the securities regulations. In practice, however, most privately-offered funds provide their investors with quarterly statements. We are concerned that 30 days may not allow sufficient time for operators of privately-offered funds to prepare and distribute quarterly statements.[49] In particular, a fund that invests in other funds (*i.e.*, a fund-of-funds) generally receives the quarterly statements of its investee funds within 30 days from quarter-end. The operator of the fund-of-funds will then need additional time to compile the quarterly statement for the fund-of-funds and distribute it to investors. Also, it is not uncommon for private investment funds to have investments in hard-to-value or illiquid assets. In these situations, funds typically engage third-party service providers for valuation services. Certain products are only valued at the end of the month, and oftentimes fund managers spend a considerable amount of time reconciling their positions/valuations with those of service providers. Accordingly, we recommend that the Commission amend Regulation 4.7(b)(2) by changing the number of days by which an operator of a fund-of-funds or an operator of a fund with illiquid or hard-to-value investments must prepare and distribute quarterly

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47 Final Rule Release on CPO and CTA Compliance Obligations, *supra* note 34 at 11268.

48 *See*, *e.g.*, CFTC Staff No-Action Letter 12-38 (Nov. 29, 2012) (providing delayed compliance date of amended part 4 for certain funds-of-funds due to the rescission of former Appendix A), available at: http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-38.pdf.

49 Regulation 4.7(b) provides qualifying operators with relief from the Regulation 4.22 requirement to provide participants with monthly account statements, provided that operators prepare and distribute to participants quarterly account statements within 30 calendar days after the end of the reporting period.

statements to pool participants from 30 days to 45 days, with a process for operators who need additional time to claim an extension.[50]

Under the Investment Advisers Act of 1940 (the "**Advisers Act**"), an adviser with "custody" of a fund's assets generally must comply with the SEC's custody rule, Rule 206(4)-2, by distributing to fund investors audited financial statements prepared in accordance with generally accepted accounting principles within 120 days of the fund's fiscal year end (180 days for a fund-of-funds). A CPO of a fund that relies on Regulation 4.7 must file with the NFA, and distribute to pool investors, certain audited financial statements within 90 days of the pool's fiscal year-end. Under Regulation 4.22(f)(2), a CPO that operates a Regulation 4.7 pool that is a fund-of-funds may claim a 90-day automatic extension, subject to the compliance with certain conditions, for the annual report for that pool. We understand many new CPOs are finding the shorter timeframe to distribute audited financial statements to be challenging, particularly for funds with Level II and Level III assets.[51] Additionally, as a large number of registrants are dually registered with the CFTC and SEC, we believe the Commission should harmonize with the Advisers Act the date by which a CPO must file with NFA and distribute to investors its Annual Report, including audited financial statements; thus, simplifying reporting requirements for dual registrants. Accordingly, we recommend that the Commission amend Regulation 4.7 by changing the date that a CPO must file with NFA and distribute to investors certain audited financial statements from within 90 days to within 120 days of the pool's fiscal year-end.

3. Systemic Risk Reporting: Forms CPO-PQR, CTA-PR, and PF

We respectfully urge the Commission to work with the SEC to harmonize systemic risk reports required to be filed by investment advisers that are registered with the Commission as CPOs and/or CTAs. Section 406 of the Dodd-Frank Act requires the Commission and the SEC to jointly promulgate rules to establish the form and content of the reports required to be filed . . . by investment advisers that are registered both under [the Advisers Act] and the Commodity Exchange Act".[52] The Commission and the SEC, however, adopted separate reporting requirements for investment advisers, CPOs, and CTAs.[53] As a result, an investment

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[50] *See, e.g.*, CFTC Regulation 4.22(f)(2). CFTC Regulation 4.22(f)(2) provides a process for an operator to claim an extension from the requirement to file audited financial statements to investors within 90 days from the end of a pool's fiscal year.

[51] *See* Financial Accounting Standards Board Statement 157 (providing an asset classification system); a summary is available at: http://www.fasb.org/summary/stsum157.shtml.

[52] Section 406 of the Dodd-Frank Act (amending section 211 of the Advisers Act).

[53] *Compare* Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, 76 *Fed. Reg.* 71128 (Nov. 16, 2011), available at: http://www.gpo.gov/fdsys/pkg/FR-2011-11-16/pdf/2011-28549.pdf; *with* Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, 77 *Fed. Reg.* 11252 (Feb. 24, 2012), available at: http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-3390a.pdf; *and* NFA Notice I-13-12, Effective Date of Amendments to NFA Compliance Rule 2-46: CPO and CTA Quarterly Reporting Requirements, April 24, 2013 (requiring CPOs that file Form PF with the SEC to file Form PQR Schedule A and a schedule of investments), available at: http://www.nfa.futures.org/news/newsNotice.asp?ArticleID=4218. The Form CPO-PQR schedule of investments is substantively similar to Form PF.

management firm registered with both the SEC and CFTC—as many of our members are—needs to file completely different forms for each quarter for its multiple investment advisers, CPOs and CTAs. NFA's Rule 2-46 requirement that each member file quarterly a schedule of investments, regardless of its size, makes the reporting obligation particularly burdensome.[54] Due to the comprehensive nature of Forms PF, CPO-PQR and CTA-PR, investment management firms expend significant resources in completing such forms, sometimes thousands of hours each quarter.

While many questions between the CFTC's and SEC's forms are similar, the forms instruct the use of different methodologies in responding to questions. MFA members have been filing the CFTC's and SEC's forms for over a year now, and continue to find the process of completing and filing the forms to be extremely burdensome in terms of both human and financial resources. Many registrants are also subject to systemic risk reporting by foreign regulators. While we recognize the political and regulatory challenge to achieve global harmonization on systemic risk reporting, we believe that at the very least, the CFTC and SEC should be harmonized in their systemic risk reporting requirements of operators and advisers of funds. We believe the Commission and the SEC should simplify and reduce reporting burdens for registrants that are dually registered with the Commission and SEC. Accordingly, we recommend that the Commission and the SEC direct their staffs to work on harmonizing Forms PF, CPO-PQR, and CTA-PR on a comprehensive basis.

IV. Protection of Customer Collateral Issues

In response to the harm that customers suffered during the 2008 financial crisis as well as resulting from the insolvencies of MF Global and Peregrine,[55] over the past few years, policy makers and regulators, including the Commission, have demonstrated a renewed focus on implementing measures to enhance customer protections.[56] MFA supports efforts to strengthen the legal framework applicable to protection of customers and their collateral because the protection of customers and their assets is essential to preserving the financial integrity of the markets. Therefore, we supported and applauded the Commission for recognizing the potential

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54 NFA Notice I-13-12, Effective Date of Amendments to NFA Compliance Rule 2-46: CPO and CTA Quarterly Reporting Requirements, April 24, 2013 (providing that CPOs that file Form PF with the SEC in lieu of CFTC Form PQR will be required to file NFA Form PQR with NFA on a quarterly basis within 60 days of the quarter end, except for the quarter ending December 31, in which the CPO can satisfy NFA's quarterly requirement by filing CFTC Form PQR (Schedule A) plus a Schedule of Investments within 60 or 90 days, depending on the size of the CPO), available at: http://www.nfa.futures.org/news/newsNotice.asp?ArticleID=4218.

55 *See supra* notes 4 and 5.

56 *See, e.g.*, Commission final rule on "Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations", 78 Fed. Reg. 68506 (November 14, 2013), available at: http://www.gpo.gov/fdsys/pkg/FR-2013-11-14/pdf/2013-26665.pdf ("**Customer Protection Rules**"); and Commission final rule on "Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions", 77 Fed. Reg. 6336 (February 7, 2012), available at: http://www.gpo.gov/fdsys/pkg/FR-2012-02-07/pdf/2012-1033.pdf ("**LSOC Rule Release**"). *See supra* note 3.

weaknesses in the customer protection regime and finalizing thoughtful measures to increase the protection and confidence of customers.[57]

However, MFA is deeply concerned by a recent regulatory trend that has emerged in discussions among global authorities, which is to erode certain key customer protections to an unreasonable degree in an effort to bail out failing institutions, like banks. To that end, below MFA highlights one regulatory initiative related to use of customer margin as part of the recovery or resolution of CCPs, which would significantly erode customer protections in the global derivatives markets and which it is important that the Commission not incorporate into its regulations. We also highlight a second issue where specific Commission action is not sufficient absent a potential amendment to the Bankruptcy code, and therefore, we would urge the Commission to consider endorsing such a change to protect enhance investor protection. Finally, we urge the Commission to consider enhancements that would provide futures customers the option to use the same third-party custodial arrangements for their collateral that the Dodd-Frank Act explicitly guaranteed for the collateral of swaps customers.

A. Recovery and Resolution of Financial Market Infrastructures

In 2013, global authorities sought public input on various measures intended to support the recovery or ease the resolution of financial market infrastructures, in particular CCPs.[58] The recovery or resolution measures that these global authorities considered and/or recommended included certain measures that are detrimental to customer protections, such as use of customer margin or margin "haircutting"[59] as a *pro rata* loss allocation tool.

MFA members are substantial users of CCP clearing services for both exchange-traded and cleared OTC derivative contracts, and their demand for such services will increase as different regulators fully implement their respective mandatory clearing initiatives.[60] As significant users of CCPs, MFA's members are exposed to the risk of losing their positions and posted collateral if a CCP fails, even though our members are indirect CCP participants that only access a CCP as a customer of a clearing member.

57 Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA, to David A. Stawick, Secretary, CFTC, dated February 15, 2013, available at: https://www.managedfunds.org/wp-content/uploads/2013/02/CFTC-Proposed-Enhancing-Customer-Protection-Rules-Final-MFA-Letter.pdf.

58 *See* the Committee of Payment and Settlement Systems and the International Organisation of Securities Commissions consultative report on "Recovery of financial market infrastructures", August 12, 2013, available at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD418.pdf; and Financial Stability Board consultative document on the "Application of Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions", August 12, 2013, available at: http://www.financialstabilityboard.org/publications/r_130812a.pdf.

59 For purposes of this letter, margin "haircutting" refers to a CCP reducing *pro rata* the amount it is due to pay participants with net in-the-money positions, while continuing to collect in full from those participants with net out-of-the-money positions.

60 In particular, Regulation 648/2012 on OTC derivatives, CCPs and trade repositories ("**EMIR**"), available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:EN:PDF; and Title VII of the Dodd-Frank Act.

MFA believes that, fundamentally, the most effective regulatory framework to address the prospect of CCP failure is one that focuses on preventing CCP failure *ex ante.* Existing financial resource requirements,[61] risk management rules, default rules, and procedures for CCPs[62] are designed to achieve a viable financial structure and a confidence buffer so that participants know that the CCPs they use will honor their contracts and repay their collateral. In the event that, despite such measures, a CCP begins to fail, we ask the Commission not to prioritize recovery and continuity of the CCP at any cost to customers. Rather, the Commission should consider the possibility that in such certain circumstances, a prompt and efficient wind-down of a failing institution, with the immediate return of customers' assets, may be achievable and preferable to a prolonged and costly recovery that is to the detriment of customers.

MFA believes that no regulator should ever permit use of customer assets as a "bail-out" or recovery or resolution tool for a CCP. MFA strongly believes that the use of non-defaulting customer margin as a loss allocation tool (either in a CCP recovery or resolution scenario) is antithetical to the G20 objective of mitigating systemic risk in the derivatives market.[63]

First, MFA strongly objects to use of customer initial margin ("**IM**") haircutting by CCPs in any CCP recovery or resolution. Customer IM is there to protect the CCP in case of a customer default. The Bankruptcy Code,[64] the Dodd-Frank Act,[65] and related Commission rules[66] all prohibit the use of a customer's posted IM to cover obligations other than those resulting from that customer's own default. Clearing members have also made it clear that, in practice, use of IM haircutting is not suitable as it will result in procyclicality and contagion as participants will be required to replenish it during periods of financial stress.[67] Therefore, in the U.S., it seems clear that policy makers, regulators, and market participants are aligned in the view that customer IM haircutting does not present a legally viable option as a CCP recovery or resolution tool. However, the derivatives market is a global market, and U.S. market participants will be subject to regulation and potentially, resolution regimes in other jurisdictions. As a

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[61] Such financial resources include, among others, margin, the CCP's own capital, guaranty fund deposits, and assessment powers. *See e.g.*, Articles 16, 41, 42 and 43 of EMIR and Article 35 of Commission Delegated Regulation (EU) No 153/2013 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on requirements for central counterparties (Commission Delegated Regulation), available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:052:0041:0074:EN:PDF.

[62] *See, e.g.*, Chapter III of EMIR, and Chapter IV of Commission final rule on "Derivatives Clearing Organization General Provisions and Core Principles", 76 Fed. Reg. 69334 (January 9 2012), available at: http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-27536a.pdf.

[63] G20 Leaders Statement – Pittsburgh Summit - September 2009, available at: http://www.g20.utoronto.ca/2009/2009communique0925.html.

[64] *See* U.S. Bankruptcy Code, 7 U.S.C. §741-753 and §761-766.

[65] *See* Sections 724 and 763 of the Dodd-Frank Act.

[66] *See* LSOC Rule Release.

[67] Financial Stability Paper No.20 on "Central counterparty loss-allocation rules", April 2013, available at: http://www.bankofengland.co.uk/publications/Documents/fsr/fs_paper20.pdf.

result, the potential use of customer IM as a loss allocation tool by legislators and regulators in those jurisdictions remains a threat to customer protections and a significant concern.

Second, use of customer variation margin ("**VM**") haircutting as a *pro rata* loss allocation tool by CCPs is not desirable and may exacerbate contagion throughout the broader financial system. In particular, VM haircutting on a portfolio or "net" basis results in the allocation of losses in a manner that is both unfair and unpredictable. Specifically, net VM haircutting allocates losses disproportionately to participants with directional positions, which are more likely to be buy-side participants[68] (as opposed to market makers, dealers and other sell-side participants, who generally maintain a risk-neutral book at the CCP). As a result, if authorities must employ VM haircutting as a CCP recovery or resolution tool, we strongly believe it should be done on a "gross" basis (*i.e.*, at the level of individual positions rather than the net portfolio of each participant). By using gross VM haircutting, a CCP would haircut every individual contract with a daily mark-to-market gain, regardless of whether the relevant participant has other positions in its portfolio that have a daily mark-to-market loss.

Therefore, MFA asks the Commission to remain mindful of the deleterious effects on customer protections of using customer margin in any way as a CCP recovery or resolution tool. If the Commission considers proposing any Commission rules or other guidance related to recovery or resolution of CCPs, we respectfully request that the Commission exclude customer margin haircutting as a loss allocation tool. In addition, as the Commission engages and coordinates with policy makers and regulators in other jurisdictions, we would appreciate the Commission's encouraging them to take this same approach.

B. Protection of Cleared Swaps Customer Collateral

MFA would appreciate the Commission's assistance in encouraging Congress to amend Chapter 7 of the Bankruptcy Code to permit significant enhancements to customer protections. MFA supports efforts to strengthen the legal framework applicable to collateral for customers related to cleared swaps transactions with FCMs. Therefore, we believe it important for the Commission to urge Congress to amend the Bankruptcy Code to bolster the protection of customer collateral.

Under current law, if an FCM becomes insolvent, all of the collateral of the FCM's cleared swaps customers would be aggregated and distributed to each customer on a *pro rata* basis.[69] Therefore, even when a customer is not at fault, if there is an insufficient amount of cleared swaps customer collateral available in the FCM's customer account to repay all customers who posted collateral, the customer would lose a portion of its posted collateral. To remedy this concern, it is important that the Commission urge Congress to amend Chapter 7 of the Bankruptcy Code so that, upon an FCM's insolvency, customer assets posted as collateral on

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68 Buy-side participants use cleared derivatives to hedge cash securities holdings, physical commodities, or positions they hold in the uncleared derivatives market.

69 *See* U.S. Bankruptcy Code, 11 U.S.C. §742, which provides that "[t]he trustee shall distribute customer property ratably to customers on the basis and to the extent of such customers' allowed net equity claims and in priority to all other claims".

cleared swaps transactions would not be subject to *pro rata* distribution. Such an amendment would ensure that cleared swaps customers do not share in any shortfall due to the FCM's or another customer's default.

An amendment to the Bankruptcy Code also would enhance the effectiveness of existing and potential segregation protections for cleared swaps customers. For example, the Commission adopted the LSOC model for cleared swaps, which should generally reduce the likelihood of there being a customer asset shortfall in certain FCM default scenarios. However, uncertainty remains as to how LSOC will perform in an FCM insolvency. An amendment to the Bankruptcy Code, as discussed above, would alleviate this uncertainty and further assure the protection of non-defaulting customers in certain FCM default situations.

In addition, market participants are continuing to consider other enhancements to customer protections, such as optional full physical segregation of customer collateral. This arrangement would allow a customer to put its collateral in an account with a custodian or other third party in the customer's name, rather than have the customer's FCM hold its collateral directly, and thus, protects the customer in the event that its FCM or another customer becomes insolvent. Without a Bankruptcy Code amendment, however, a cleared swaps customer's physically segregated collateral might be considered part of the pool of customer assets of the insolvent FCM, and thus, distributed on a *pro rata* basis. Therefore, MFA believes that amending Chapter 7 of the Bankruptcy Code significantly would enhance customer protection.

C. Protection of Futures Customer Collateral

As mentioned, MFA remains concerned about the MF Global and Peregrine insolvencies. The misuse or misplacement of customer funds in those situations resulted in customers experiencing a delay, in some cases a significant delay, in the return or outright loss of substantial amounts of their assets.[70]

In light of the MF Global and Peregrine failures, MFA feels it is also appropriate for the Commission to re-examine the protections available to participants in the futures market, and to assess the appropriate balance between the costs of enhanced protections versus the costs to investors and the market as a whole of a segregation failure. As mentioned, we appreciate the Commission finalizing the Customer Protection Rules. As a further step, we think that the Commission should hold one or more roundtables, as it did when considering segregation rules for cleared swaps,[71] to ensure full consideration of the lessons learned, and to assess whether further protections of the collateral of futures customers are appropriate, potentially including additional customer protections that might be achieved via the Bankruptcy Code amendment discussed above for cleared swaps.

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[70] *See supra* notes 4 and 5.

[71] *See* Commission Staff Roundtable to Discuss Protection of Cleared Swaps Customer Collateral, June 3, 2011, available at: http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission6_060311-transcri.pdf .

In addition, MFA believes that the Commission should repeal Interp. 10-1, which prohibits futures customers from holding their collateral in accounts at a third-party custodian, rather than with their FCM counterparty. Although the CEA already requires an FCM to maintain all customer collateral separate from the FCM's own funds,[72] it is also important that futures customers have the option to maintain their collateral remotely from their FCM counterparties at a third-party custodian. Allowing futures customers to use third-party custodial accounts is an important step towards safeguarding customers' assets because those accounts would: (1) protect one futures customer from another futures customer's default; (2) protect futures customers from FCM operational and investment risk; and (2) facilitate the prompt transfer of futures customers' positions and collateral upon their FCM counterparty's default.

Many of MFA's largest members already have third-party custodial accounts in place in the OTC derivatives market for collateral they have posted on uncleared swap positions. Moreover, when the Commission adopted the LSOC model for protection of cleared swaps collateral, the Commission clarified that the prohibition on the use of third-party custodial accounts contained in Interp. 10–1 does not apply to collateral posted by cleared swaps customers.[73] MFA believes that there is no difference between cleared/uncleared swapson the one hand and futures on the other that supports limiting futures customers' use of third-party custodial accounts. Accordingly, we think it is important for the Commission to repeal Interp. 10-1 for futures so that all customers have the option of equal protection of their collateral regardless of what products they trade.

Therefore, MFA requests that the Commission repeal Interp. 10-1 for futures and allow futures customers the option to use third-party custodial accounts to ensure that the collateral that futures customers post is protected in a manner that is robust and equal to the protections available to swaps customers. We have attached a copy of the repeal request that MFA and AIMA submitted to Commission Staff as Appendix F.

V. Rulemaking Proposals on Position Limits

MFA members rely on fair, competitive, and transparent markets that respond to fundamental market factors to conduct their businesses. MFA members play a vital role in the derivatives industry by assuming price risk from commercial participants (hedgers) on the long and short sides of the market, and providing the liquidity that facilitates price discovery and risk transfer for businesses around the world. Our members participate in the marketplace when they trade futures and swaps and when they invest in other financial entities or institutions and operating companies. Accordingly, MFA members are interested in the impact the Commission's new position limits regime will have on them and their investors.

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72 *See* CEA, 7 U.S.C. §6d(f).

73 *See* LSOC Rule Release at 6343 (agreeing that Interp. 10-1 does not apply to cleared swaps, and therefore, an FCM may deposit cleared swaps customer collateral at a bank in a third-party safekeeping account without being deemed in violation of section 4d(f) of the CEA).

A. Position Limits Proposal

With respect to the Commission's proposal on position limits for derivatives ("**Position Limits Proposal**"),[74] MFA recommends that if the Commission decides to impose spot-month limits on financially settled futures contracts, it should use different methodology in calculating spot-month position limits for cash-settled and physically-delivered contracts. Although there may be a valid rationale for establishing spot-month position limits for physically-settled contracts based on deliverable supply, there is no economic rationale for linking position limits on cash-settled contracts to deliverable supply. Setting position limits for cash-settled contracts in the same manner as for physically-settled contracts may unnecessarily constrain legitimate risk management activity. While MFA believes that the Commission should adopt final rules that do not impose position limits on cash-settled contracts, if it does proceed, the Commission should not impose the same methodology for both cash-settled and physically-delivered contracts. Among the three alternatives presented in the Position Limits Proposal though, MFA believes the second alternative to the conditional spot-month limit exemption, which sets the limit for cash-settled contracts at five times the level of the limit for the physical-delivery core referenced futures contract regardless of a trader's positions in the underlying physical-delivery contract, will best preserve price discovery and market participation. We are concerned that some of the other proposals will incentivize some traders to trade only in the cash-settled contract, adversely affecting price discovery and liquidity in the physical-delivery contract.

In setting position limits on physically-delivered contracts, MFA urges the Commission to determine estimated deliverable supply using the most recent and reliable data that is available to it, rather than use deliverable supply data, which in some cases in the Positions Limits Proposal is decades old.[75]

MFA contends that the Commission's approach to the establishment of non-spot month and all-months-combined position limits is too simplistic in its reliance on a uniform percentage of open interest applied to all referenced contracts. This one-size-fits-all methodology does not factor in seasonal fluctuations, other fluctuations based on trends, global events or economic forces, or traders' built-in cushions for the prevention of position limits violations, which likely will result in: (1) a self-reinforcing cycle of lower position limits; (2) no flexibility to modify position limits based on liquidity needs relating to external forces; and (3) position limits that are actually different for similar contracts traded on different exchanges because such contracts have different unit sizes. Moreover, we are concerned that the inaccuracy of the swaps data that is reported to the Commission undermines the establishment of appropriate non-spot month position limit levels.

Finally, we are concerned that the Position Limits Proposal creates uncertainty around the determination of which contracts will be deemed to be referenced contracts, especially with

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[74] Position Limits for Derivatives, 78 Fed. Reg. 75680 (proposed Dec. 12, 2013); Extension of comment periods, 79 Fed. Reg. 37973 (July 3, 2014).

[75] For example, estimated deliverable supply for natural gas has not been updated since 1996 and gold and silver have not been updated since 1983.

respect to customized OTC swaps. We are concerned that the Commission could determine retrospectively that a particular customized OTC swap is a referenced contract despite a good-faith determination by a market participant that such swap is not a referenced contract, thus exposing the market participant to potential liability. The Commission should describe the methodology it used in determining the list of contracts that staff considers to be referenced contracts to provide clarity to market participants in their analysis of customized contracts.

MFA submitted more comprehensive comments on the Position Limits Proposal, and has attached a copy of our letter as Appendix G.

B. Aggregation Limits Proposal

MFA members are particularly concerned about the impact the Commission's Aggregation of Positions proposal[76] (the "**2013 Aggregation Proposal**") will have on them, in particular because MFA members may implement multiple independent trading strategies, may be invested in "owned entities" (including operating companies that are not commodity pools), and may be passive owners in the fund-of-funds context. Member firms may execute multiple, independent trading strategies that are implemented by different and separate business units or employees. Many MFA member firms, as part of their investment strategy, invest in one or more, and sometimes multiple, small-, mid-sized and/or large operating companies. In addition, some MFA member firms use a fund-of-funds structure to make investments, whereby a master fund holds a passive interest and invests in other, separately-managed funds. Without disaggregation relief, such business units and master funds would be required to aggregate all of their positions with those of the separately-managed business units, operating companies or funds. Accordingly, such relief is critical to our members' ability to pursue varying investment strategies to achieve the investment goals of those investing in hedge funds.

First, MFA believes that a passive ownership interest in operating companies should be exempted from the Commission's aggregation rules absent other indicia of common trading control. A passive owner of an operating company should not be required to investigate into the trading activity of an owned-operating company, and, a small passive owner will find it very difficult to do so and to obtain the information required by the Commission to satisfy the disaggregation criteria under proposed rule 150.4(b)(2) because small passive owners are not large or important enough to garner the attention of the operating company. Thus, as a practical matter, most small passive owners in operating companies will not be able to avail themselves of the relief under proposed rule 150.4(b)(2). MFA believes that to provide meaningful disaggregation relief to passive owners of operating companies, the Commission should increase the 10 percent aggregation threshold to 25 percent with respect to passive ownership in an owned operating company.

We support providing disaggregation relief for greater than 50 percent-owned entities, but the Commission's application process for such entities seeking exemptive relief appears to be highly discretionary and introduces unnecessary uncertainty with its open-ended review period.

[76] Aggregation of Positions, 78 Fed. Reg. 68946 (proposed Nov. 15, 2013); Extension of comment periods, 79 Fed. Reg. 37973 (July 3, 2014).

We recommend that the Commission adopt a notice filing procedure applicable to such relief and more transparent standards for relief. With respect to the Commission's proposed conditions for exemptive relief, however, we believe the proposed conditions are unduly restrictive and that the Commission has not justified the requirement that all positions be *bona fide* hedging transactions or, if the positions of the owned entity do not so qualify, the owned entity's positions must not exceed 20 percent of the applicable speculative position limit.

Second, we believe that the Commission should remove the passive ownership limitation from the Commission's independent account controller exemption that applies to a manager that is exempt from registration as a CPO under CFTC Regulation 4.13 in light of the rescission of CFTC Regulation 4.13(a)(4). Proposed regulation 150.4(b)(1)(iii) retains the current condition that does not provide disaggregation relief for a passive investor that holds a direct or indirect 25 percent or greater ownership or equity interest in a commodity pool where the operator of the pool is exempt from registration under CFTC Regulation 4.13.[77] There is no need to apply this restriction to funds that rely on CFTC Regulation 4.13(a)(3), which by definition are permitted only to invest in a *de minimis* amount of commodity interests, *i.e.*, a 5% initial margin limitation, or a 100% net notional value limitation, which should protect against concerns about excessive speculation by such funds. MFA respectfully requests that the Commission eliminate this restriction from the final rule or in the alternative, eliminate the restriction with respect to CFTC Rule 4.13(a)(3) exempt pools. Failure to do so will have the practical effect of creating a trap for passive investors in CFTC Rule 4.13 exempt commodity pools who do not control investment decisions or have the ability to monitor or access information relating to investments in such investee funds.

MFA submitted more comprehensive comments on the 2013 Aggregation Proposal, and has attached a copy of our letter as Appendix H.

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[77] Proposed rule 150.4(b)(1)(iii), Aggregation of Positions, 78 Fed. Reg. at 68976.

We appreciate your consideration of these issues. We hope to meet with you in the near future to discuss our concerns. Please do not hesitate to contact the undersigned at (202) 730-2600 with any questions that the Commission or its staff might have regarding this letter.

Respectfully submitted,

/s/ Stuart J. Kaswell

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

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