INVESTMENT ADVISER ASSOCIATION

2014 Comments & Statements

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Via Electronic Mail

Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506

Re: FINRA Request for Comment on Proposed "Pay to Play" Rule (Regulatory Notice 14-50)

Dear Ms. Asquith:

The Investment Adviser Association ("IAA")[1] appreciates the opportunity to comment on proposed rules of the Financial Industry Regulatory Authority ("FINRA") that would regulate covered members engaged in solicitation activities for compensation with government entities on behalf of investment advisers.[2] The IAA supports FINRA's decision to move forward with its pay to play rule, which is largely consistent with the SEC's pay to play rule. We recommend, however, that FINRA modify the proposed disclosure requirements in Rule 2271 to parallel the SEC regulatory framework for third-party solicitation activities on behalf of investment advisers. We also provide a technical comment to proposed Rule 4580, which would impose new recordkeeping requirements in connection with such activities.

Background

Rule 206(4)-5 under the Investment Advisers Act of 1940 (the "Advisers Act") is intended to prevent advisers and their employees from making political contributions for the purpose of obtaining or retaining advisory contracts with government entities (the "SEC Rule"). The SEC Rule also generally prohibits an investment adviser and its covered associates from doing anything indirectly which, if done directly, would result in a violation of the SEC Rule. The SEC Rule specifically prohibits an adviser and its covered associates from providing or agreeing to provide, directly or indirectly, payment to any third party for solicitation of advisory

[1] The IAA is a not-for-profit association that represents the interests of investment adviser firms registered with the Securities and Exchange Commission ("SEC"). Our membership consists of investment advisory firms that manage assets for a wide variety of institutional and individual clients, including public pension plans, trusts, investment funds, endowments, and foundations. A number of our member firms are either dually registered or have related firms that are registered as broker-dealers and are members of FINRA. For more information, please visit our website: www.investmentadviser.org.

[2] See FINRA Regulatory Notice 14-50 (November 2014) ("FINRA Notice").

business from any government entity on behalf of such adviser, unless the third party is a "regulated person." A regulated person, in relevant part, includes a registered broker or dealer subject to restrictions adopted by FINRA that are "substantially equivalent or more stringent" than the SEC Rule and consistent with its objectives. Although advisers have been required to comply with most provisions of the SEC Rule since March 14, 2011, the SEC delayed the compliance date of this "third-party solicitor" aspect of the SEC Rule at least in part so that FINRA could adopt a pay to play rule for broker-dealers.[3]

The Proposed Written Disclosure Requirement Should Not Apply to a Solicitor that is a Related Person of the Adviser

The Proposed Disclosure Requirement is Inconsistent with the SEC's Approach to Solicitations by Related Persons

Proposed Rule 2271 (the "Proposed Rule") would require a third-party solicitor to make specified disclosures in writing and provide them at the time of the initial distribution[4] or solicitation, and is modeled largely on Rule 206(4)-3 under the Advisers Act, the SEC's cash solicitation rule. Like proposed Rule 2271, Rule 206(4)-3 is intended primarily to address conflicts of interest inherent in certain solicitation arrangements by alerting a potential client who is approached by a solicitor that the solicitor is being compensated by the investment adviser. We note, however, that the Proposed Rule departs from the provision of the SEC's cash solicitation rule that excludes from its written disclosure requirement solicitors that are related persons or affiliates of the investment adviser ("related persons").[5]

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[3] On June 8, 2012, the SEC extended the compliance date for the third-party solicitor provisions of the SEC Rule from June 13, 2012 until nine months after the compliance date of the SEC rule requiring registration of municipal advisor firms. The final rule for municipal advisor registration included a phased-in compliance schedule. The FINRA Notice states that the compliance date for these provisions is April 1, 2015; but the June 2012 release stated that the SEC plans to formally issue the new compliance date in the *Federal Register*, which it has yet to do. Therefore, the final compliance date has not been formally set. See *Political Contributions by Certain Investment Advisers: Ban on Third-Party Solicitation; Extension of Compliance Date,* Rel. No. IA-3418 (June 13, 2012).

[4] The term "distribution" is used throughout the proposed rules but not defined. We note that under the SEC Rule, the term is used solely in the context of solicitation of investment advisory services. For consistency, we recommend that FINRA clarify that this and other terms in FINRA's proposed rules have the same meaning as used in the SEC Rule, unless otherwise defined.

[5] Under Rule 206(4)-3(a)(2)(ii), a solicitor that is (A) a partner, officer, director or employee of the investment adviser or (B) a partner, officer, director or employee of a person which controls, is controlled by, or is under common control with such investment adviser is required to disclose to the client at the time of solicitation the status of such solicitor as a partner, officer, director or employee of such investment adviser or other person, and any affiliation between the investment adviser and such other

In adopting Rule 206(4)-3, the SEC recognized that in circumstances where "inside" or "related" solicitors are involved, a prospective client would be aware that the solicitor is marketing on behalf of its own company's advisory services and could consider this fact in deciding whether to follow the solicitor's recommendation.[6] The SEC noted, however, that this may not necessarily be the case with respect to unaffiliated solicitors. As a result, the written disclosure requirements of the cash solicitation rule are applicable only to a third-party solicitor that is not related to the investment adviser.[7]

Many investment advisers compensate their related broker-dealers (who, in turn, may compensate their employees and/or associated persons) for soliciting or referring government entities to them for investment advisory services. Requiring related solicitors to provide written disclosure would be a substantial departure from the SEC's cash solicitation rule. As the SEC recognized, the disclosures are unnecessary because the potential government entity client would be sufficiently alerted to the fact that there may be potential conflicts by the affiliated status of the solicitor. Therefore, we recommend that FINRA defer to the SEC's prior policy determinations regarding solicitation activities of persons that are related to the adviser, and revise the Proposed Rule to incorporate the cash solicitation rule's exception for related solicitors.[8]

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person. The written disclosure requirements set forth Rule 206(4)-3(a)(2)(iii)(A) are not applicable to such related persons.

[6] See *Requirements Governing Payments of Cash Referral Fees by Investment Advisers*, Rel. No. IA-615 (Feb. 2, 1978).

[7] See Rule 206(4)-3(a)(2)(iii)(A). However, under the cash solicitation rule, related solicitors are required to disclose to potential clients (orally or in writing) the status of such affiliation at the time of the solicitation or referral. See Rule 206(4)-3(a)(2)(ii).

[8] Moreover, we note that when the SEC proposed its pay to play rule, the ban on third-party solicitations would not have applied to related persons of the investment adviser. The SEC stated that the intent of this exclusion was to "enable advisers to compensate parent companies and other owners, subsidiaries and sister companies – as well as employees of related companies – for government entity solicitation activities because… there may be efficiencies in allowing advisers to rely on these particular types of persons to assist them in seeking clients." The SEC also stated that it determined to "make this distinction because related person solicitors are subject to an adviser's (or its affiliates') control and thus should not present the compliance challenges that advisers cited with respect to third-party solicitors." In adopting the final Rule, the SEC modified its proposal to eliminate this exception in light of the fact there would be an exclusion from the third-party solicitor ban for "regulated persons" that are themselves subject to prohibitions against engaging in pay to play practices. See *Political Contributions by Certain Investment Advisers*, Release No. IA-2910 (Aug. 3, 2009).

Requiring Related Persons of Advisers to Make Written Disclosures Would Impose a Significant Compliance Burden

The IAA also urges FINRA to consider the potential costs and benefits that would result from imposing the written disclosure requirement on solicitors that are related to the investment adviser. We submit that the costs and burdens associated with the proposals would outweigh any perceived benefits. We are especially concerned that it would be difficult for employees of related solicitors to overcome the substantial obstacles to complying with this requirement on a "real-time" basis, as discussed below.

In practice, communications between employees of related solicitors and prospective clients may be made principally for reasons other than soliciting particular investment advisory business.[9] For example, in business structures where investment advisory services are offered by a company through related firms as part of its overall services, a dedicated sales force of employees and/or registered representatives may sell not only one product line, but numerous products or services ranging from banking services, insurance services, or investments that would not otherwise be covered by pay to play rules.

In addition, registered representatives acting on behalf of related investment advisers may engage in discussion with government entity officials where at any given moment the registered representative may be asked to discuss separate accounts of the adviser or investment opportunities in mutual funds excluded from pay to play rules (e.g., an investment in an investment pool that is not an investment option of a plan or program of the government entity).[10] For example, in the course of a registered representative's discussion with a government official about one product line or account, the official could also express an interest in additional advisory services of the related adviser. The representative may also make a referral by providing the government official with information (such as a brochure) regarding the company's related investment advisory services. It would be impractical to require that a written disclosure document be prepared in advance of these conversations, especially when the related solicitor must be prepared to respond to client feedback on investment strategies by seamlessly comparing various product or service offerings.

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[9] By contrast, concerns over pay to play practices are heightened where a third-party solicitor is engaged exclusively for the purpose of soliciting certain government entities.

[10] Similar to FINRA's proposals, Rule 206(4)-5 applies to advisers that advise a "covered investment pool" in which a government entity invests. These include (i) the investment of public funds in unregistered investment companies, such as hedge funds, private equity funds and venture capital funds and (ii) pooled investment vehicles sponsored or advised by an adviser as a funding vehicle or option within a participant-directed plan or program of a government entity (e.g., 529, 403(b) and 457 plans).

Further complications could result for "dual employees" of the adviser and the related broker-dealer where a lack of alignment could impose additional compliance burdens. The SEC staff has stated that if an adviser's employee is also employed by a related broker-dealer to solicit government clients on behalf of the adviser, and the adviser pays the broker-dealer for the employee's solicitation services, then the broker-dealer would have to be a "regulated person" under the SEC Rule thus subjecting the adviser's employee to FINRA's pay to play rule.[11] Unless FINRA's rules are consistent with the SEC Rule, these dual employees would face the additional burden of complying with a FINRA written disclosure requirement.

Therefore, the IAA recommends that proposed Rule 2271 be modified to follow the SEC's cash solicitation rule by excluding related persons of the adviser from the written disclosure requirement.[12] The proposed text reflecting this revision is attached as an Appendix.

The Timing and Updating Requirements Relating to the Written Disclosures Would Be Unworkable and Would Impose Significant Compliance Burdens

In the alternative, if FINRA determines to proceed with the Proposed Rule without the exclusion for related persons, we request that the timing and updating requirements be revised. As currently drafted, the disclosures would be required in writing and "at the time of the initial distribution or solicitation." In addition, any material changes to the information provided in these disclosures would have to be updated within 10 calendar days of such change.

We are concerned with the feasibility of requiring written disclosures on a "real time" basis at the time of initial solicitation. For example, the disclosure regarding relationships between the covered member and any person affiliated with the government entity would likely require extensive research and due diligence.[13] A readily available document containing general disclosures would not satisfy the Proposed Rule as currently drafted. The written disclosure would have to be highly customized and tailored to the specific facts of

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[11] Further, according to the SEC Staff, the dual employee would also be a covered associate of the adviser because of his or her solicitation activities, even if these activities were performed in the capacity as an employee of the broker-dealer. See SEC Staff Responses to Questions About the Pay to Play Rule, Question IV.2, available at: http://www.sec.gov/divisions/investment/pay-to-play-faq.htm.

[12] We note that this exclusion would be limited to a person soliciting on behalf of a *related* adviser and would not extend to solicitation activities on behalf of unaffiliated advisers.

[13] In light of the proprietary and confidential nature of the compensation paid by advisers to related persons, we also recommend that FINRA clarify that only a general description and terms of the fee arrangements would be required.

each particular solicitation and government entity. It would be unlikely that adequate disclosure could be prepared and provided in writing at the time of initial solicitations and be monitored and updated on a continuous basis. We note, also, that "initial" solicitations could include chance encounters at public events, thereby making it nearly impossible for the solicitor to comply with this requirement.

Thus, the IAA recommends permitting solicitors to provide the disclosure and any material updates, at any time prior to the execution of a written contract between the investment adviser and the government entity client.[14] We believe that this approach would balance the need to provide such information in a timely manner and the solicitor's obligation to provide information that is accurate and complete.

Technical Comments Concerning Proposed Rule 4580 (Recordkeeping)

Proposed Rule 4580 would require the maintenance of relevant books and records. The FINRA Notice states that the proposed rule is intended to be consistent with similar recordkeeping requirements imposed on investment advisers in connection with the SEC Rule and cites to Rule 204-2 under the Advisers Act. However, we note that the draft rule text accompanying the Notice inadvertently excludes this reference. We therefore recommend that the text of proposed Rule 4580(d) be revised by adding a reference to Rule 204-2.

* * *

We appreciate the opportunity to provide comments on the proposed rules and would be pleased to provide any additional information. Please contact the undersigned or Kathy D. Ireland, Acting General Counsel, at (202) 293-4222 with any questions regarding these matters.

Respectfully submitted,

/s/ Sanjay Lamba

Sanjay Lamba
Assistant General Counsel

[14] The IAA also recommends that FINRA take into account that, during some transactions, third-party solicitors may communicate with consultants hired by government entities to search for investment opportunities, and clarify that delivery of disclosure documents to a consultant where the consultant has agreed, in writing, to provide the document to the government entity would satisfy the disclosure requirement.

APPENDIX

REVISED PROPOSED RULE TEXT

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2200. COMMUNICATIONS AND DISCLOSURES

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2271. Disclosure Requirement for Government Distribution and Solicitation Activities

(a) Other than a covered member specified in paragraph (b) of this Rule, ~~A~~a covered member engaging in distribution or solicitation activities for compensation with a government entity on behalf of one or more investment advisers shall, at the time of the initial distribution or solicitation on behalf of each investment adviser, disclose to such government entity in writing (which may be electronic) the following information with respect to each investment adviser:

(1) The fact that the covered member is engaging in distribution or solicitation activities on behalf of the investment adviser;

(2) The name of the investment adviser on whose behalf the covered member is engaging in distribution or solicitation activities;

(3) The nature of the relationship, including any affiliation, between the covered member and the investment adviser;

(4) A statement that the covered member will be compensated by the investment adviser for its distribution or solicitation activities and the terms of such compensation arrangement, including a description of the compensation paid or to be paid to the covered member;

(5) Any incremental charges or fees that may be imposed on the government entity as a result of the distribution or solicitation activities engaged in by the covered member;

(6) The existence and details of any pecuniary, employment, business or other relationships between the covered member or any covered associate and any person affiliated with the government entity that has influence in the decisionmaking process in choosing an investment adviser; and

(7) The existence of the covered member's internal policies and procedures with respect to political contributions by covered associates and other associated persons.

(b) A covered member who is (A) a partner, officer, director or employee of such investment adviser or (B) a partner, officer, director or employee of a person which controls, is controlled by, or is under common control with such investment adviser shall disclose to the government entity at the time of distribution or solicitation the status of such covered member as a partner,

officer, director or employee of such investment adviser or other person, and any affiliation between the investment adviser and such other person.

(~~b~~c) A covered member shall, during any period in which it is engaging in distribution or solicitation activities for compensation with a government entity on behalf of an investment adviser, update in writing (which may be electronic) any material changes to the information previously provided to the government entity pursuant to~~under~~ ~~this~~paragraph (a) of this Rule within 10 business days of the date of such change.

(~~c~~d) The terms used in this Rule 2271 shall have the same meaning as defined in Rule 2390.

* * * * *

October 28, 2014

Via Electronic Mail

Outsourcing Workgroup
(Attention: Banking Department II)
Monetary Authority of Singapore
10 Shenton Way, MAS Building
Singapore 079117

Re: Consultation Papers on Notice and Guidelines on Outsourcing Management

Dear Ladies and Gentlemen:

The Investment Adviser Association (IAA) appreciates the opportunity to comment on the MAS's recent consultation papers on a proposed Notice and proposed Guidelines relating to the management of outsourcing arrangements by financial institutions. The IAA is a not-for-profit US association that represents the interests of investment adviser firms registered with the US Securities and Exchange Commission (SEC). Our membership consists of investment advisory firms that manage assets for a wide variety of institutional and individual clients, including pension plans, trusts, investment funds, endowments, foundations, and corporations, and many of our members have affiliates that are licensed or registered as fund management companies in Singapore.[1]

Our comments relate to (1) the proposal of mandatory measures under the Notice rather than the Guidelines' approach of permitting firms to "tailor" the Guidelines to their particular circumstances; (2) the potential application of the proposed Notice and Guidelines to outsourcing arrangements between fund management companies and their affiliates and other related entities; and (3) the proposed requirement in the Notice that a fund management company that uses an overseas service provider obtain prescribed written confirmations from the provider's supervisory authority.[2] In addition, we request at least a one-year transition period following the publication of the final Notice and Guidelines to allow fund management companies and other financial institutions time to implement the new requirements.

Risk-Based Guidelines More Appropriate Than Mandatory Measures

We appreciate the MAS's goals of enhancing risk management practices and ensuring that financial institutions manage their outsourcing arrangements prudently. We respectfully

[1] For more information, please visit our website: www.investmentadviser.org.

[2] Although our comments primarily relate to fund management companies, we note that other types of regulated entities would face similar issues under the proposals.

submit, however, that the existing Guidelines follow the proper approach in providing risk-based recommendations rather than inflexible requirements. Under the current Guidelines, firms are permitted to implement the guidance to the extent and degree "commensurate with the nature of risks in, and materiality of, the outsourcing arrangement."[3] The adoption of a "one size fits all" regime is not appropriate in this context, especially given the broad range of financial institutions that would be affected by the proposed Notice.[4] Accordingly, we respectfully recommend that any Notice or revised Guidelines continue to take a risk-based approach to oversight of outsourcing arrangements.

Application of Notice and Guidelines to Affiliates and Other Related Parties

In particular, we request that the MAS reconsider the proposed Notice and Guideline provisions that would treat an arrangement between a financial institution and its affiliate or other related party as an "outsourcing arrangement." Financial institutions and their affiliates and other related parties may be separate entities for a variety of corporate, legal and tax reasons. Given their relationships, a financial institution's service provider agreements with affiliates and other related firms do not raise the same risks as contracts with third parties.

For example, the proposed Notice's requirement of an independent audit of material outsourcing arrangements at least every three years[5] would be inappropriate to arrangements with related service providers. In the case of a fund management company, for example, the operational and control risks of related service providers would be easily ascertainable; therefore, an independent audit would not be necessary. Fund management companies therefore should be able to take a risk-based approach to determining whether certain audits would be necessary, consistent with the current Guidelines. We therefore request that the MAS reconsider the scope of the proposed Notice and Guidelines with respect to this and other standards as they apply to related service providers.

Confirmation by Overseas Service Provider's Supervisory Authority

We also urge the MAS to remove the provision in the proposed Notice that would require that financial institutions that contract with overseas service providers obtain and provide the MAS with certain written confirmations from the supervisory authority of the

[3] Guidelines on Outsourcing at ¶ 2.1. This provision also appears in the proposed Guidelines.

[4] We note, for example, that the indemnifications that would be required by the proposed Notice at ¶ 5.1(c) would not be necessary under most circumstances because liability on the part of the MAS in accessing and inspecting service providers would be highly unlikely. In addition, it may be burdensome and difficult for financial institutions to persuade service providers to agree to these types of broad indemnifications.

[5] Proposed Notice on Outsourcing at ¶ 7.1.

service provider. One such required confirmation would be the ability of the MAS and independent auditors to access the company's documents and records stored or processed by the service provider.[6] We submit that the proposed confirmation requirement would subject these arrangements to a substantial degree of uncertainty and unduly limit the universe of available service providers, given that many supervisory authorities would be unwilling or unable to provide such a confirmation. For example, the SEC is not required to provide its registrants with such a confirmation and may not respond to such a request at all, on time, or with the appropriate terms; therefore, licensed fund management companies and other financial institutions, in effect, could be prohibited entirely from contracting with SEC-regulated entities.

As an alternative, we suggest that the MAS pursue these objectives through existing channels, including memoranda of understanding (MOUs) with its international counterparts. The MAS MOU with the SEC and other U.S. financial regulators should provide sufficient assurances to the MAS, without the necessity for further confirmations on the part of the U.S. regulators.

Transition period for implementation

The adoption of the proposed Notice and the amended Guidelines could necessitate extensive changes in business operations and renegotiation of numerous service provider agreements. We therefore request that the MAS provide at least a one-year transition period after publication of the final Notice and Guidelines to allow firms time for implementation.

* * *

We appreciate the opportunity to provide our views on these issues and would be pleased to provide any additional information. Please contact the undersigned at (202) 293-4222 with any questions regarding these matters.

Respectfully submitted,

Kathy D. Ireland
Kathy D. Ireland
Associate General Counsel

[6] *Id.* at ¶ 9.1.

October 9, 2014

Via Electronic Mail

Wholesale Conduct Policy Team
Markets Division
Financial Conduct FCA
25 The North Colonnade
Canary Wharf
London E14 5HS

Re: FCA Discussion Paper DP14/3 (July 2014)

Dear Ladies and Gentlemen:

The Investment Adviser Association (IAA) appreciates the opportunity to comment on Discussion Paper 14/3, relating to the use of dealing commission regime.[1] The IAA is a not-for-profit US association that represents the interests of investment adviser firms registered with the US Securities and Exchange Commission (SEC). Our membership consists of investment advisory firms that manage assets for a wide variety of institutional and individual clients, including pension plans, trusts, investment funds, endowments, foundations, and corporations, and many of our members manage, or have affiliates that manage, assets for UK clients.[2]

Investment advisers in the US are subject to a fiduciary standard in the management of their clients' assets, which encompasses the important principles of trust, loyalty, and duty of care. Our members must act in the best interests of clients and place the interests of clients before their own. This duty is over-arching and includes transparency, particularly the duty to disclose, among other things, potential conflicts of interest that may arise in the course of advisers' services. We therefore support transparency in advisers' dealings with clients. We have concerns, however, about the sweeping changes contemplated in the Discussion Paper, including whether they would ultimately benefit clients.

Introduction

The Discussion Paper reflects on the prior work of the FCA and recent changes to the Conduct of Business sourcebook (COBS) concerning the use of dealing commission by investment managers, and concludes that further reform is required. In particular, the FCA is considering two options: (1) adopting the proposed restrictions on "inducements" under recent amendments to the European Union's Markets in Financial Instruments Directive (MiFID II),

[1] FCA Discussion Paper, DP14/3 (July 2014) (Discussion Paper).

[2] For more information, please visit our website: www.investmentadviser.org.

which may be interpreted to limit the use of dealing commission to "minor, non-monetary benefits;" or (2) requiring the complete unbundling of research and execution arrangements. For reasons similar to those expressed in our February 25, 2014 comment letter on FCA Consultation Paper CP13/17 and our recent response to the European Securities and Markets Authority (ESMA) on its May 2014 consultation paper on MiFID II, we are concerned about the implications of each of these options.

MiFID II Limitation to "Minor Non-Monetary Benefits" (Option 1)

The ESMA Consultation Paper proposes to interpret the ban on "inducements" in MiFID II Level 1, Article 24(8), very broadly and to limit the exception for "minor non-monetary benefits" very narrowly. Under ESMA's proposed analysis, MiFID II would permit the use of dealing commission to acquire only the most generic, widely available commentary, and disallow the use of dealing commission to acquire most types of research used by investment managers. We provided a detailed analysis of ESMA's proposals in our July 31, 2014 comment letter, which is attached.

In general, we disagreed with ESMA's proposed interpretation of the use of dealing commission as a *per se* inducement. Such arrangements, when properly structured and disclosed, are beneficial for clients and do not impair a manager's duty to act in its clients' best interests. We also urged ESMA to reconsider its proposed narrow interpretation of "minor non-monetary benefits," and allow managers to determine the appropriateness of a particular arrangement by applying the "best interests of the client" standard, seeking best execution for every client trade, and providing clear disclosure to clients concerning any potential conflicts of interest. In addition, we explained the adverse market implications for investment managers doing business on a global basis, and detailed the increased costs that could result from ESMA's proposed interpretation.

For these reasons, we do not support the FCA's adoption of ESMA's proposed approach to the use of dealing commission under MiFID II.

Potential Ban on Linking Research to Execution Arrangements (Option 2)

Given the disadvantages of ESMA's proposed interpretation of MiFID II, we urge that the FCA not take the even more extreme approach by requiring that UK investment managers fully unbundle research and execution. In particular, we note that many investment managers operate their businesses and provide their services on a global basis, and the proposed standards would not be consistent with those of other jurisdictions, including the US, and

even other EU member states, under some circumstances.[3] For example, in the US, section 28(e) of the Securities Exchange Act of 1934 provides a safe harbor under which investment managers may use "soft dollars" for research. Other countries provide similar safe harbors.

The establishment of UK rules that differ from other jurisdictions could disadvantage UK clients and/or discourage investment managers from offering their services in the UK. For example, as we noted in our earlier letter, many managers place their orders for securities transactions on a "block" basis, which generally benefits their clients. Under such arrangements, orders from UK advisory firms may be aggregated with orders from non-UK affiliates in a group that uses a fully integrated trading and research platform. This practice aims to achieve economies of scale and to treat orders from different clients equitably. If the commissions related to these orders were to be used for research, managers may feel compelled to separate out UK clients from these otherwise advantageous arrangements.[4] If UK rules are not harmonized with those in other jurisdictions, the result could disadvantage UK clients, and present practical, logistical, and client relations issues.

Investment managers also may opt not take on UK clients, if they conclude that they cannot provide the same benefits to UK clients as they can provide to their other clients. Either result could ultimately disadvantage UK clients. Under certain circumstances, managers may not be able to effectively "ring fence" the arrangements for UK clients without potentially negative consequences.

We also believe that the FCA should fully consider the costs of unbundling execution and research. Currently, a "hard" cost for research is not readily available to investment managers, and brokers do not have an established or consistent means for valuing research. If unbundling were required, both the sell-side and the buy-side would have to implement new procedures and structures to assign costs to research and assess those costs; however, the use of dealing commission regime does not directly impact brokers. Therefore, managers could face challenges in obtaining pricing for research, and any final FCA action on this topic

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[3] We do not agree with the Discussion Paper's assertion that the MiFID II proposed changes would mitigate any competitive disadvantage for UK firms. First, MiFID would not apply to non-EU firms. Second, as the Discussion Paper notes, the MiFID II restrictions would not affect EU managers to UCITS funds or alternative investment fund managers under the AIFM Directive, and the Discussion Paper suggests that it would consider imposing the complete unbundling across the board if the EU elected to limit the restrictions to MiFID managers. Discussion Paper at 19. If the FCA were to take this step, it would create further disadvantages to UK investment managers to UCITS funds and AIFMs as compared with other EU managers.

[4] We note that the limitations on aggregating account trades under COBS 11.3.7R generally allow aggregation only where such aggregation would benefit the client; therefore, not allowing otherwise advantageous aggregation would operate to disadvantage UK clients. Moreover, the systematic disadvantaging of UK clients could arguably cause advisory firms to contravene COBS 11.3.2(2)R, which requires that a firm "carry out otherwise comparable orders sequentially and promptly unless the characteristics of the order or prevailing market conditions make this impracticable, or the interests of the client require otherwise."

should require brokers to provide this cost information.[5] In addition, any such action should allow a sufficient transition period for all of the parties to adjust their business models, and establish pricing structures, along with related compliance controls.

As to the overall impact on the market, we are concerned that unbundling could result in a decrease in the amount of research available in the market because of the increased compliance responsibilities for managers and brokers. In this regard, we disagree with the Discussion Paper's conclusion that reduced research coverage is not expected. A reduction in the amount of research could negatively impact small and medium-sized managers who rely on external research, as well as market liquidity as a result of a reduction in the number of analyses of individual stocks, particularly small cap issuers.

* * *

We believe that the concerns expressed by the FCA can be more appropriately addressed by allowing market-driven decisions by investors who are provided with fully transparent disclosure. In entering into a dealing commission arrangement, an investment manager should assess (1) whether the particular arrangement enhances the quality of service to its clients; (2) whether the arrangement and any potential conflicts of interests have been adequately disclosed to its clients; and (3) whether its ability to act in clients' best interests would be impaired. The options contemplated by the FCA would essentially prohibit these arrangements, even if they were in the client's best interests, and we urge the FCA to consider less radical measures.

We appreciate the opportunity to provide our views on these issues and would be pleased to provide any additional information. Please contact the undersigned or Karen L. Barr, General Counsel, at (202) 293-4222 with any questions regarding these matters.

Respectfully submitted,

Kathy D. Ireland
Kathy D. Ireland
Associate General Counsel

Attachment

[5] The FCA itself noted that "most brokers appeared to be unwilling or unable to provide [detail over the cost and price of their research]," and encourages brokers and investment managers to enter into discussions about pricing research. Discussion Paper at 26. Our members have reported anecdotally that many brokers continue to resist providing detail over the cost and price of their research.

September 9, 2014

The Honorable Mary Jo White
Chair
Securities and Exchange Commission
100 F Street, NE Washin
gton, DC 20549

Re: Request for Commission Action With Respect to CUSIP Identifiers

Dear Chair White:

The Bond Dealers of America (BDA)[1], the Investment Adviser Association (IAA)[2], and the Government Finance Officers Association of the United States and Canada (GFOA)[3], have corresponded and met with former Chairs Schapiro and Walter as well as numerous staff at the Securities and Exchange Commission (SEC) on several occasions beginning in 2010 to express our deep concerns regarding the operation of the CUSIP system, SEC rules that require the use of CUSIP numbers, and the collection of fees by Standard and Poors (S&P) for usage of CUSIP's standard security identifiers. Copies of our previous written communications are attached.

To date, the SEC has not addressed our concerns nor taken any concrete action on these matters.

Since our initial meetings and correspondence, the onerous practices employed by S&P that impact market participants continue unabated. S&P continues to impose increasingly burdensome fees on issuers, underwriters, investment advisers, broker/dealers, investors, and others for the acquisition,

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[1] BDA (www.bdamerica.org) is the Washington, DC based organization that represents securities dealers and banks active in the U.S. fixed income markets. BDA is the only organization representing the unique interests of these dealers. In addition to federal advocacy, the BDA hosts a series of meetings and conferences specific to domestic fixed income.

[2] The IAA (www.investmentadviser.org) is a not-for-profit association that represents the interests of SEC-registered investment adviser firms. Founded in 1937, the IAA's membership consists of approximately 550 firms that collectively manage in excess of $14 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, endowments, foundations, and corporations.

[3] GFOA (www.gfoa.org) is a professional association of government finance offices in Chicago, Illinois with approximately 18,000 members. GFOA is a not-for-profit association whose purpose is to enhance and promote the professional management of governments.

retention, and use of CUSIP identifiers. Further, language contained in CUSIP licensing agreements administered by S&P severely restricts the use of CUSIP identifiers in marketing materials and documents mandated by federal and state regulators.

In contrast to the inaction by U.S. regulators to address this issue, the European Commission acted quickly and decisively to acknowledge the problem and impose safeguards which protect market participants and promote competition in the marketplace. Nearly five years ago, the European Commission (EC) determined that S&P's identical actions in the European Economic Area were abusive and anti-competitive. In 2009, the EC commenced formal proceedings against S&P regarding S&P's practices as to licensing fees for International Securities Identification Numbers (ISINs) including CUSIPs. In November 2009, the EC issued a formal Statement of Objections to S&P outlining the EC's preliminary view that S&P was abusing its dominant position regarding CUSIPs by requiring financial institutions and information service providers to pay unfair licensing fees for the use of securities identifiers in the firms' own databases. The EC found that other securities identification providers either do not charge fees at all or, if they do, do so only on the basis of distribution costs as opposed to usage. The EC, in its Statement of Objections to S&P, found that S&P does not incur any costs for the distribution of its security identifiers to financial institutions. The EC made a preliminary finding that S&P's practices are abusive. In May 2011, after discussions with S&P, the EC issued an official notice implementing a new competition policy for the European Economic Area (EEA). The Commission also published for comment proposed commitments of S&P to lower fees. The terms of the commitment are:

- S&P will no longer charge indirect users of the ISIN numbers in the EEA.
- Users receiving direct access to the number separately will be limited to paying S&P $15,000 per year over the next five years (inflation adjusted).
- S&P clients with current contracts in Europe are entitled to an early termination of their contracts. However, users will be prohibited from extracting the numerically similar CUSIPs on which US ISINs are based from the US ISIN data and from redistributing in bulk US ISINs to companies other than affiliates located within the EEA.

By June 14, 2011, the EC received and considered comments concerning the alleged overcharging for the use of ISINs issued in the United States and used in the EEA. The final EC order is now effective by consent (a complete summary of the EC decision is attached).

Implementation of the EC order proceeded smoothly for market participants with little impact on the free-flow of information within the market itself. However, the EC order expires in 2016 and a determination by the Commission on permanent or temporary renewal—or expiration—of the order has not been reached.

In light of constraints on market participants imposed by S&P and its CUSIP licensing requirements, Bloomberg Open Symbology has introduced a Bloomberg Global ID, which provides global market identifiers that may serve as an alternative to the CUSIP. The Bloomberg Global Identifier (BBGID) is a 12-character alpha-numeric identifier that can be assigned to all active and non-active securities, including cross references to CUSIPs. The BBGID carries no licensing fees and no restrictions on usage. Despite the potential of the BBGID, current SEC regulations that specifically require use of the CUSIP identifier in securities transactions prohibit issuers, broker/dealers, investment advisers, and other market participants from abandoning CUSIP identifiers in favor of a less restrictive, but equally effective, alternative identifier.

We believe the continued acceleration of activities in the U.S. tied to CUSIP licensing fees and the legal action taken against S&P by the European Commission provide sufficient basis for the SEC to initiate a review of practices and procedures employed by S&P. Further, we believe the efforts of the private sector in providing an alternative to the CUSIP identifier are a positive step in the direction of injecting much needed competition into the marketplace for securities identifiers.

We respectfully ask you to immediately commence a review of S&P's licensing practices relating to CUSIP identifiers. Further, we ask the SEC to review current regulations that require use of a CUSIP identifier and to consider revisions to these regulations to permit use of other globally-recognized identifiers.

We would be pleased to respond to questions or to provide any additional information you or your staff may need.

Thank you for your attention to this important matter.

Sincerely,

Mike Nicholas
Chief Executive Officer
Bond Dealers of America
21 DuPont Circle, NW
Suite 750
202.204.7901

David G. Tittsworth
President & CEO
Investment Adviser Association
1050 17th Street, NW
Suite 725
1301 Pennsylvania Ave., NW Washington, DC 20036
Ste. 309
202.293.4222

Dustin McDonald
Director, Federal Liaison Center
Government Finance Officers Association
Washington, DC 20036
Washington, DC 20004
703.395.4896

Enclosures

- Letter to The Honorable Mary L. Schapiro, Chairman, Securities and Exchange Commission, dated November 10, 2010
- Letter to The Honorable Elisse Walter, Chairman, Securities and Exchange Commission, dated January 30, 2013
- Summary of the European Commission Decision, currently in effect

cc:
Commissioner Luis Aguilar

Commissioner Daniel Gallagher
Commissioner Michael Piwowar
Commissioner Kara Stein

August 29, 2014

VIA ELECTRONIC MAIL

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

Re: Compliance with Registration Requirements Under Amended Regulations 4.5 and 4.13(a)(3)

Dear Mr. Barnett:

The Investment Company Institute,[1] the Investment Adviser Association,[2] the Managed Funds Association,[3] the Asset Management Group of the Securities Industry and Financial

[1] The Investment Company Institute ("ICI") is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $17.3 trillion and serve over 90 million shareholders.

[2] The Investment Adviser Association ("IAA") is a not-for-profit association that represents the interests of investment adviser firms registered with the Securities and Exchange Commission. The IAA's members collectively manage in excess of $14 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations. For more information, please visit our website: www.investmentadviser.org.

[3] The 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

Markets Association[4] and the Alternative Investment Management Association[5] seek to clarify the letter, dated as of January 25, 2013 (attached hereto as Exhibit A), pursuant to which the ICI, the IAA, the MFA and the AMG respectfully requested that the Division of Swap Dealer and Intermediary Oversight ("DSIO" or the "Division") of the Commodity Futures Trading Commission (the "Commission" or "CFTC") grant relief to permit sponsors of registered investment companies ("registered funds") and privately offered investment funds ("private funds," together with registered funds, "funds") to net certain uncleared swaps held by a fund when applying the net notional test in amended Regulation 4.5 or 4.13(a)(3), as applicable (the "January 25 Letter").[6]

Specifically, the January 25 Letter requested that the DSIO grant relief that would permit a fund to net uncleared swaps for purposes of the net notional test provided that (1) the termination dates of the offsetting swaps are the same and (2) the reference asset or rate for the offsetting swaps is the same. Further, the January 25 Letter requested that such netting should be permitted regardless of whether the counterparties to the offsetting swaps are identical as the purpose of the *de minimis* limitations is to limit commodity interest exposure.[7]

Following up on a meeting Jennifer Wood[8] and Cary J. Meer[9] had with DSIO staff on March 5, 2014, we would like to amend the original request in the January 25 Letter as follows: we request that the DSIO grant relief that would permit a fund to net uncleared swaps for purposes of the net notional test provided that (1) the termination dates of the offsetting swaps are the same, (2) the reference asset or rate for the offsetting swaps is the same and (3) the swaps to be netted are either (A) with the same counterparty or (B) with different counterparties, but the offsetting swaps are both outstanding only for seven business days or fewer.

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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.

[4] The Asset Management Group ("AMG") of the Securities Industry and Financial Markets Association's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 pension funds and private funds such as hedge funds and private equity funds.

[5] The Alternative Investment Management Association ("AIMA") is the trade body for the hedge fund industry globally; its membership represents all constituencies within the sector – including hedge fund managers, funds of hedge fund managers, prime brokers, fund administrators, accountants and lawyers. Its membership comprises over 1,300 corporate bodies in over 50 countries.

[6] *Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations*, 77 Fed. Reg. 11252 (Feb. 24, 2012) ("Adopting Release"); *correction notice published at* 77 Fed. Reg. 17328 (Mar. 26, 2012).

[7] *See* Adopting Release, *supra* note 6, at 11256 (noting that the purpose of the trading limitations is to limit a fund's exposure to commodity interests).

[8] Jennifer Wood is a Director of AIMA and the Head of Asset Management Regulation of AIMA.

[9] Cary J. Meer is a Partner at the Washington, D.C. office of K&L Gates LLP.

We maintain the request that the relief make clear that, if the notional amounts of the offsetting swaps are not the same, the amount netted should be equal to the smaller of the two notional amounts. In these circumstances, the offsetting swaps serve to reduce the fund's exposure to commodity interests, which is fully consistent with the purpose of the trading thresholds in Regulations 4.5 and 4.13(a)(3).

For the reasons discussed in this letter and the January 25 Letter, we believe it would be appropriate for the DSIO to allow the operator of a fund to net its uncleared swaps as outlined above when calculating the net notional test under amended Regulation 4.5 or 4.13(a)(3), as applicable.

* * * * *

We appreciate the Division's prompt consideration of this request. If you have questions or require further information, please contact ICI (Dorothy M. Donohue at 202/326-5800, Sarah A. Bessin at 202/326-5835 or Rachel H. Graham at 202/326-5819), IAA (Karen L. Barr at 202/293-4222), MFA (Stuart Kaswell or Jennifer Han at 202/730-2600), SIFMA AMG (Matt Nevins at 212/313-1176) or AIMA (Jennifer Wood at +44 (0) 20 7822 8380).

Sincerely,

/s/Dorothy M. Donohue

Dorothy M. Donohue Acting
General Counsel Investment
Company Institute

/s/ Karen L. Barr

Karen L. Barr
General Counsel
Investment Adviser Association

/s/ Stuart J. Kaswell

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

/s/ Timothy W. Cameron

Timothy W. Cameron
Managing Director, Asset Management Group
Securities Industry and Financial Market Association

/s/ Matthew J. Nevins

Matthew J. Nevins
Managing Director and Associate General Counsel, Asset Management Group
Securities Industry and Financial Market Association

/s/ Jiří Król

Jiří Król
Deputy CEO, Head of Government and Regulatory Affairs
Alternative Investment Management Association

cc: Amanda Olear, Special Counsel
Michael W. Ehrstein, Attorney – Advisor
Division of Swap Dealer & Intermediary Oversight, CFTC

January 25, 2013

VIA ELECTRONIC MAIL

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

Re: Compliance with Registration Requirements Under Amended Regulations 4.5 and 4.13(a)(3)

Dear Mr. Barnett:

The Investment Company Institute,[1] the Investment Adviser Association,[2] the Managed Funds Association,[3] and the Asset Management Group of the Securities Industry and Financial

[1] The Investment Company Institute ("ICI") is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $13.9 trillion and serve over 90 million shareholders. As a result of the CFTC's recent amendments to Regulation 4.5, many registered investment advisers that advise registered investment companies must register as commodity pool operators. Although ICI has judicially challenged amended Regulation 4.5, see Complaint, Investment Company Institute, et al. v. CFTC, Case No. 1:12-cv-00612 (D.D.C. Apr. 17, 2012), it is committed to assisting its members' efforts to comply with the amended regulation.

[2] The Investment Adviser Association ("IAA") is a not-for-profit association that represents the interests of investment adviser firms registered with the Securities and Exchange Commission. Founded in 1937, the IAA's membership consists of more than 550 advisers that collectively manage in excess of $10 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations. For more information, please visit our web site: www.investmentadviser.org.

[3] The 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

Markets Association[4] respectfully request that the Division of Swap Dealer and Intermediary Oversight ("DSIO" or the "Division") of the Commodity Futures Trading Commission (the "Commission" or "CFTC") grant relief to permit sponsors of registered investment companies ("registered funds") and privately offered investment funds ("private funds," together with registered funds, "funds") to net certain uncleared swaps held by a fund when applying the net notional test in amended Regulation 4.5 or 4.13(a)(3), as applicable.[5] As discussed briefly below, we believe that such relief would be consistent with the intent of these regulations (i.e., to limit use of commodity interests by funds operated by persons excluded from the definition of commodity pool operator ("CPO") or exempt from CPO registration) without thwarting the policy goals underlying the regulations.

To rely on amended Regulation 4.5 or 4.13(a)(3), a fund must satisfy one of two trading thresholds. One of those thresholds, known as the net notional test, requires that the aggregate net notional value of the fund's commodity interest positions, determined at the time the most recent position was established, does not exceed 100 percent of the liquidation value of the fund's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into.[6] Each regulation, along with the existing staff guidance,[7] permits netting of (1) futures contracts and options with the same underlying commodity across designated contract markets and foreign boards of trade and (2) swaps cleared on the same derivatives clearing organization where appropriate. Neither regulation, however, explicitly permits the netting of uncleared swaps.

We respectfully request that the DSIO grant relief that would permit a fund to net uncleared swaps for purposes of the net notional test provided that (1) the termination dates of the offsetting swaps are the same and (2) the reference asset or rate for the offsetting swaps is the same. Such netting should be permitted regardless of whether the counterparties to the offsetting

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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.

[4]The Asset Management Group ("AMG") of the Securities Industry and Financial Markets Association's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 pension funds and private funds such as hedge funds and private equity funds.

[5] *Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations*, 77 Fed. Reg. 11252 (Feb. 24, 2012) ("Adopting Release"); *correction notice published at* 77 Fed. Reg. 17328 (Mar. 26, 2012).

[6] Amended Regulation 4.5 permits the operator of a registered fund to exclude *bona fide* hedging positions (within the meaning and intent of Regulations 1.3(z)(1) and 151.5), but Regulation 4.13(a)(3) does not.

[7] *See Division of Swap Dealer and Intermediary Oversight Responds to Frequently Asked Questions – CPO/CTA: Amendments to Compliance Obligations* (August 14, 2012, as amended) (answer to question 3 under the heading "Trading Limits").

swaps are identical as the purpose of the *de minimis* limitations is to limit commodity interest exposure.[8] We also request that the relief make clear that, if the notional amounts of the offsetting swaps are not the same, the amount netted should be equal to the smaller of the two notional amounts. In these circumstances, the offsetting swaps serve to reduce the fund's exposure to commodity interests, which is fully consistent with the purpose of the trading thresholds in Regulations 4.5 and 4.13(a)(3).

Without the requested relief, both the long exposure and the short exposure on offsetting swaps would have to be counted for purposes of the net notional test. This would overstate the fund's actual exposure to the underlying commodity interests.[9] We recognize that a fund could terminate the swap to avoid this overcounting. We have learned from our members, however, that this approach would cause two additional problems, which ultimately would increase costs for or otherwise disadvantage fund investors.

First, terminating the swap is likely to be more costly than entering into an offsetting position. In this case, an existing counterparty would charge a termination fee that could be greater than the cost of entering into an offsetting transaction with the same or a different counterparty. As a result, the fund is likely to receive less favorable execution than if it were able to consider terms for an offsetting position from multiple counterparties. The regulations should not create an incentive for a fund to deal with only one (and perhaps a more expensive) counterparty solely because of regulatory benefits from dealing with that counterparty over others.

Second, terminating the swap would cause the fund to realize gain or loss for tax purposes earlier than would be required if an offsetting swap is entered into. In addition, except to the extent the straddle rules apply, it may cause a fund to realize short term gain rather than long term gain (which is currently taxed at a lower rate), which would reduce the returns for fund investors.

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[8] *See* Adopting Release, *supra* note 5, at 11256 (noting that the purpose of the trading limitations is to limit a fund's exposure to commodity interests).

[9] By way of illustration, assume a fund has a long uncleared swap with a termination date of March 31, 2013 with counterparty A. The fund manager wants to roll over that swap, so the manager obtains competitive bids and determines it would be in the best interests of the fund to roll the swap forward with counterparty B instead of counterparty A. To accomplish this, the manager could enter into a short uncleared swap on the same reference asset or rate with the same termination date (March 31, 2013) with counterparty B, and also enter into a new long swap on the same reference asset or rate with a later termination date also with counterparty B. In such circumstances, until the first termination date (March 31, 2013 in this example) has passed, the manager may need to count all three swaps in calculating the fund's compliance with the net notional test in Regulations 4.5 and 4.13(a)(3), thus overstating the fund's actual exposure to the reference rate or asset. When the manager enters into the offsetting swap and the new swap with counterparty B, it reduces the spread that counterparty B charges for the positions and therefore gives the fund a better overall execution price for the rollover than if the manager had entered into the offsetting swap with counterparty A and the new swap with counterparty B.

For the reasons discussed in this letter, we believe it would be appropriate for the DSIO to allow the operator of a fund to net its uncleared swaps as outlined above when calculating the net notional test under amended Regulation 4.5 or 4.13(a)(3), as applicable.

* * * * *

We appreciate the Division's prompt consideration of this request. If you have questions or require further information, please contact ICI (Karrie McMillan at 202/326-5815, Sarah A. Bessin at 202/326-5835 or Rachel H. Graham at 202/326-5819), IAA (Karen L. Barr at 202/293-4222), MFA (Stuart Kaswell or Jennifer Han at 202/730-2600), or SIFMA AMG (Tim Cameron at 212/313-1389).

Sincerely,

/s/Karrie McMillan

Karrie McMillan
General Counsel
Investment Company Institute

/s/ Karen L. Barr

Karen L. Barr
General Counsel
Investment Adviser Association

/s/ Stuart J. Kaswell

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

/s/ Timothy W. Cameron

Timothy W. Cameron
Managing Director, Asset Management Group
Securities Industry and Financial Market
Association

cc: Amanda Olear, Special Counsel
Michael W. Ehrstein, Attorney – Advisor
Division of Swap Dealer & Intermediary Oversight, CFTC

Exhibit A

July 31, 2014

Via Electronic Mail

Mr. Steven Maijoor
Chair
European Securities and Markets Authority
103 rue de Grenelle
75007 Paris, France

Re: ESMA Consultation Paper: MiFID II/MiFIR (May 2014)

Dear Mr. Maijoor:

The Investment Adviser Association (IAA) appreciates the opportunity to comment on ESMA's Consultation Paper regarding the new Markets in Financial Instruments Directive (MiFID II) and the measures relating to the legitimacy of inducements paid to/by third parties.[1] Specifically, we address the practice of certain investment managers agreeing to execution rates from brokers that include financial research as part of the brokers' overall services (dealing commissions).[2] The IAA is a not-for-profit U.S. association that represents the interests of investment adviser firms registered with the U.S. Securities and Exchange Commission. Our membership consists of investment advisory firms that manage assets for a wide variety of institutional and individual clients, including pension plans, trusts, investment funds, endowments, foundations, and corporations. Many of our member firms manage, or have affiliates that manage, assets for European clients.[3]

Investment advisers in the U.S. are subject to a fiduciary standard in the management of their clients' assets, which encompasses the important principles of trust, loyalty, and duty of care. Our members must act in the best interests of clients and place the interests of clients before their own. This duty is over-arching and includes transparency, particularly the duty to disclose and mitigate, among other things, potential conflicts of interest that may arise in the course of their services.

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[1] MiFID Level 1, Article 24(8); ESMA Consultation Paper, Section 2.15, pp. 118-125.

[2] As used in this letter, the term "dealing commissions" refers to "soft" commissions (or "soft dollars" as referred to in the United States), bundled brokerage, or commission sharing arrangements.

[3] For more information, please visit our website: www.investmentadviser.org.

We commend ESMA for considering these important issues and support efforts to strengthen investor protections and increase clarity for clients. We agree with ESMA that regulations should ensure that investors are accurately informed about potential conflicts, including all fees, commissions, and benefits the investment firm may receive from third parties in connection with providing investment services. We have concerns, however, about ESMA's proposed interpretations that would appear to effectively ban the use of dealing commissions by global investment managers to obtain investment research on behalf of their EU clients. Obtaining research from dealing commissions in order to promote the interest of clients should not be deemed a *per se* "inducement" under MiFID II. The IAA believes that such arrangements, when properly structured and disclosed, are beneficial for clients and do not impair a manager's duty to act in its clients' best interest. We also believe that potential conflicts inherent in dealing commission arrangements can be addressed through increased transparency and robust disclosure. This would allow investors to make choices about these arrangements that are appropriate for them.

Our comments below relate primarily to: (1) ESMA's proposed narrow interpretation of the term "minor non-monetary benefits" as it relates to financial research; (2) the implications of ESMA's proposals for investment managers that do business on a global basis, and (3) the additional costs that would be imposed on market participants in order to comply with the proposed requirements.

Introduction

MiFID II places restrictions on the ability of investment firms providing investment advice on an independent basis and portfolio management (hereinafter referred to collectively as "managers") to accept and retain fees, commissions, or any monetary or non-monetary benefits from third parties. However, MiFID II provides an important exemption for certain "non-monetary benefits" that are: (1) deemed "minor;" (2) clearly disclosed to the client; (3) capable of enhancing the quality of the service provided; and (4) do not, or could not be judged to, impair the ability of investment firms to act in the best interest of their clients. As noted in the Consultation Paper, MiFID II contemplates that the receipt of minor non-monetary benefits should be permitted for "all MiFID investment and ancillary services, not only for independent advice or portfolio management" in accordance with the conditions outlined in MiFID II.

The Consultation Paper discusses the potential for financial research purchased by independent managers to be permissible as a minor non-monetary benefit. ESMA states that the exemption should be narrowly construed and proposes that only financial research that is intended for a large number of persons or for the general public be permitted (i.e., widely-disseminated, generic research that is generally not of high value). ESMA also states that such benefits should only qualify as "minor" where they are "reasonable and proportionate

and of such scale that they are unlikely to influence the recipient's behavior in any way that is detrimental to the interests of the relevant client."

The Consultation Paper further suggests that any research involving a third party allocating valuable resources to a specific portfolio manager "could be judged to impair compliance with the portfolio manager's duty to act in their client's best interest" and thus considers such non-monetary benefits to not be "minor" for purposes of the exemption. ESMA, in particular, singles out the practice of portfolio managers agreeing to higher execution rates in exchange for "higher value research" from a broker. ESMA states that this practice intrinsically impairs compliance with the portfolio manger's duty to act in its client's best interest. ESMA's proposed interpretations would thus appear to be a *per se* ban on dealing commission arrangements by independent managers to obtain useful research regardless of whether it is in the client's best interest. In effect, ESMA has determined that such arrangements are, by default, ***not*** in the client's best interest. For the reasons set forth below, the IAA disagrees with this blanket assertion.

ESMA Should Reconsider its Proposed Narrow Interpretation of Minor Non-Monetary Benefits

The IAA is concerned that ESMA's proposed interpretation of the term minor non-monetary benefit could effectively ban dealing commission arrangements that are beneficial to clients, consistent with the managers' duty to act in their client's best interest, and reasonably proportionate to the overall fee being charged to the client (i.e., if the commission were to be "unbundled," the costs associated with the research component would be "minor" relative to the execution costs). In our view, such an interpretation would go beyond the conditions outlined in MiFID II.

Dealing commission arrangements may benefit investors by facilitating the ability of investment managers to obtain important information and analysis that assists with their investment decisions. These arrangements provide managers with a broad range of financial information that can be used to make more informed investment decisions for their clients. We note that these types of arrangements are especially beneficial to clients of smaller managers who may not be able to provide certain in-house research on a cost efficient basis. While we recognize that there are potential conflicts of interest in such arrangements, we believe that the ability of clients to receive these services should not be limited to the receipt of widely-disseminated generic research that is of little value. Rather, the determination of what is appropriate within the MiFID II guidelines should be at the discretion of managers, bearing in mind their obligations to act in their clients' best interest.

The IAA believes that potential conflicts inherent in dealing commission arrangements can and should be addressed through clear disclosure to clients, combined with adoption and implementation of policies and procedures designed to ensure that such arrangements are

beneficial to the client and that they will not impair the manager's duty to act in the client's best interest. We also note that, consistent with their duty to seek best execution, managers may decide to place a lower value on broker research while agreeing to pay a commission that is higher than available elsewhere because they value the overall execution services that the broker provides. In addition, we note that investment managers already have incentives to manage transaction costs, including dealing commissions, due to the direct impact such costs have on investment returns – which are of primary importance to clients.

The IAA actively supports full and fair disclosure of the use of client commissions for research and brokerage services under U.S. law. As a fiduciary, a U.S. investment adviser has an obligation to seek best execution in connection with client transactions and to disclose potential conflicts of interest to existing and prospective clients. The duty of best execution requires an adviser to seek to execute securities transactions for clients in such a manner that the client's total cost or proceeds is the most favorable under the circumstances. In addition to enhanced disclosure requirements, we support efforts to clarify the types of products and services that constitute permissible research under applicable law and encourage the preservation of third-party research to the extent it is in the best interest of clients.

Market Implications for Managers Doing Business on a Global Basis

ESMA's proposals would, in effect, require independent managers to "unbundle" dealing commission arrangements and would represent a significant change for the global market. Due to the global nature of asset management and the supply of execution and research goods and services, many investment managers operate their businesses and provide their services on a global basis. ESMA's proposals could result in standards that would not be consistent with those of other jurisdictions, including the U.S., and would require advisers to substantially change their global compliance infrastructures to accommodate EU-specific requirements, to the likely detriment of EU clients or international clients using EU managers.

The IAA is also concerned these proposals could adversely impact the overall level of research coverage in the international market and the competitiveness of the EU markets in particular. A wholesale ban on obtaining research through dealing commissions would put EU managers at a competitive disadvantage to their counterparts in the U.S. and Asia. For example, if "unbundling" were only required in the EU, firms that increase their asset management fees for EU clients to offset costs for obtaining financial information separately would be perceived as charging higher management fees than their international competitors.

The establishment of EU rules that differ from other jurisdictions could also disadvantage EU clients, and/or discourage investment managers from offering their services in the EU. For example, many managers place their orders for securities transactions on a "block" basis, which generally benefits their clients, and orders from EU firms may be aggregated with orders from non-EU affiliates in a group that uses a fully integrated trading

and research platform.[4] This practice aims to achieve economies of scale and to treat orders from different clients equitably. If the commissions related to these orders were deemed impermissible for MiFID II purposes, managers may feel compelled to separate out EU clients from these otherwise advantageous arrangements. If EU rules are not harmonized with those in other jurisdictions, the result could disadvantage EU clients, and present practical, logistical, and client relations issues. It could also lead to EU clients engaging non-EU managers to avoid these disadvantages.

In the alternative, investment managers may decide not to take on EU clients if they determine that they cannot provide the same benefits to EU clients as they can provide to other clients. Either result could ultimately disadvantage EU clients. Under certain circumstances, managers may not be able to effectively "ring fence" the arrangements for EU clients without potentially negative consequences.

The proposed changes could also affect smaller managers who may not be able to develop certain in-house research and are forced to pay increased prices for research from external providers. We submit that this could ultimately lead to a reduction in the number of asset managers, which would limit the choice available to EU investors.

Cost Implications of ESMA's Proposed Interpretations

ESMA's proposed interpretations also would impose additional costs on market participants in the EU. Specifically, ESMA's proposed interpretations would effectively mean the "unbundling" of financial research from dealing commission arrangements, except for the most generic, widely available commentary. However, ESMA offers no cost-benefit analysis of effectively requiring managers to separately purchase high value research on behalf of clients. We submit that that the costs associated with the proposals would be substantial relative to any perceived benefits. For example, global managers would have to implement specific compliance procedures to satisfy EU-specific requirements. Moreover, even for EU managers there would be substantial cost associated with setting up compliance procedures to unbundle. We note also that there may be logistical challenges from the sell side in meeting these arrangements which could further increase the costs associated with these proposed interpretations.

ESMA's proposals are based on the assumption that there either is or will be an established market for every service with a "hard" cost. However, we believe that this information is not currently readily available and that it is possible that brokers may not be

[4] Under EU regulations, aggregation is permitted where: (1) it is unlikely that the aggregation will disadvantage the client; (2) it is disclosed to the client, including the fact that the aggregation may work to its disadvantage; and (3) an order allocation policy is established and effectively implemented. See e.g., Articles 48 and 49 of the MiFID Implementing Directive.

willing or able to provide this information. We note that the proposed changes would affect only the responsibilities of independent managers, and not impose any obligations on the brokers providing the research to disclose information concerning pricing. In addition, some brokers may not cooperate in providing a value or even accept payments from an investment manager's own resources for such services. Even if brokers provided estimated prices for these services, prices among brokers would inevitably vary, depending on the methodologies and assumptions underlying the estimates. Thus, we are concerned that managers would face difficulties in documenting compliance with this unbundling requirement, because brokers do not have an established or consistent means for valuing research.

We are also concerned that the proposal could result in a reduction of research available in the market. For example, certain research topics may no longer be covered because brokers may not deem it profitable to provide this information. These topics are likely to be in the less mainstream areas where smaller managers may operate, again increasing the burdens that would be imposed on such managers. Moreover, a reduction in the number of differing views about stocks could have an overall negative impact on market liquidity. This could disproportionately affect small cap issuers as it would not be economical for managers to pay a "hard" cost for specialist research on such companies.

There may also be an increase in the administrative expense of tracking payments for research on an ongoing basis (separately and apart from the broker's commission) in an effort by the manager to document the overall execution rate. Furthermore, the increased compliance burdens under the proposal would fall disproportionately on small and medium-sized managers that may rely more heavily upon external research.

In addition, even if advisers declined to receive proprietary research along with execution services from brokers, there are no assurances that commission rates would be reduced proportionately. The current arrangements are cost-effective for end investors as they allow managers to obtain a wide array of research while paying reasonable commissions in relation to the value received. The effect of an up-front charge for all research (other than minor generic research) would be to reduce the amount of research to which managers have access without necessarily decreasing costs. Thus, paying "hard dollars" for research without a correlating decrease in the execution rate would mean an overall increase in fees for clients without any additional benefits.

If ESMA determines to proceed with its proposed recommendations, we request that ESMA impose an explicit requirement on brokers to provide information to managers regarding the costs of the associated research or other products and/or services provided along with the execution costs. We submit that unless this requirement is in place, it will be costlier for managers to comply with the proposed new obligations and there may be little or no benefits passed onto clients. We believe that better transparency by brokers and disclosure of costs would be more cost-effective in mitigating the conflict of interest stemming from the

use of dealing commissions to acquire external research. More transparency from brokers would also permit investment managers to implement better controls and compliance infrastructures regarding commissions paid to brokers.

* * *

The IAA agrees it is important for clients to know about any conflicts of interests that may be present in the dealing commission arrangements of their investment managers. We respectfully submit that allowing market-driven decisions by investors on the basis of fully transparent disclosure is a more appropriate and cost-effective way to address the goals of the MiFID II inducement measures than eliminating the use of dealing commissions. Thus, we urge ESMA to reassess its proposed interpretations relating to inducements and minor non-monetary benefits. We urge ESMA to clarify that, with respect to all research, investment managers have the opportunity to assess whether their particular dealing commission arrangements enhance the quality of services for clients, whether they have adequately disclosed such arrangements, including any potential conflicts of interest that may be present, and whether their ability to act in the best interest of their clients would be impaired. Finally, we recommend that ESMA provide independent managers affected by the proposed changes sufficient time to assess the impact of the rules on their business models and implement related compliance controls.

We appreciate the opportunity to provide our views on these issues and would be pleased to provide any additional information. Please contact the undersigned or Karen L. Barr, General Counsel, at (202) 293-4222 with any questions regarding these matters.

Respectfully submitted,

/s/ Sanjay Lamba
Assistant General Counsel

July 21, 2014

Ms. Melissa D. Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Petition for Rulemaking to Amend CFTC Regulations 1.31, 4.7(b) and (c), 4.23 and 4.33

Dear Ms. Jurgens:

Managed Funds Association[1] ("MFA"), the Investment Adviser Association[2] ("IAA"), and the Alternative Investment Management Association[3] ("AIMA") (together, the "Associations" or the "Petitioners") respectfully petition the Commodity Futures Trading Commission (the "Commission" or the "CFTC") under CFTC Regulation 13.2 to amend (i) CFTC Regulation 1.31, which in part sets forth electronic recordkeeping and third-party

[1] 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] IAA is a not-for-profit association that represents the interests of investment adviser firms registered with the Securities and Exchange Commission (the "SEC"). Founded in 1937, the IAA's membership consists of more than 550 advisers that collectively manage approximately $14 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations. For more information, please visit its website: www.investmentadviser.org.

[3] AIMA is the trade body for the hedge fund industry globally; its membership represents all constituencies within the sector – including hedge fund managers, funds of hedge fund managers, prime brokers, fund administrators, accountants and lawyers. Its membership comprises over 1,300 corporate bodies in over 50 countries.

technical consultant requirements; (ii) CFTC Regulations 4.7(b) and (c), which in part set forth recordkeeping requirements applicable to those registrants relying upon such exemptions; (iii) CFTC Regulation 4.23, which sets forth recordkeeping requirements generally applicable to commodity pool operators ("CPOs"); and (iv) CFTC Regulation 4.33, which sets forth recordkeeping requirements generally applicable to commodity trading advisors ("CTAs").

In particular, the Petitioners request that the Commission amend CFTC Regulation 1.31 to provide relief relating to certain electronic recordkeeping requirements applicable to CPOs and CTAs, including the requirement to use a third-party technical consultant. In addition, the Petitioners request that the Commission expand the list of permissible entities that may maintain records in CFTC Regulations 4.7(b) and (c), 4.23, and 4.33 to permit a CPO or CTA to retain any third party as a recordkeeper, as long as the CPO or CTA, as applicable, bears all responsibility for maintaining and producing required records pursuant to the Commission's regulations.

For the reasons set forth below, the Petitioners also respectfully request temporary time-limited no-action relief on an expedited basis to last until the Commission adopts final rules relating to this petition and such rules become effective.

The text of the requested rule amendments is set forth in Appendix A to this letter.

I. Nature of Petitioners' Interest

The Petitioners collectively represent a broad segment of the global investment management industry. For purposes of this petition, the Petitioners represent managers, investment advisers, and sub-advisers to many types of pooled investment vehicles and separate accounts, many of which trade commodity interests. As a result of the changes to the Part 4 regulations adopted by the CFTC in 2012[4] and the adoption of a broad definition of the types of swaps subject to CFTC regulation,[5] many of these managers, investment advisers, and sub-advisers registered as CPOs and/or CTAs as of January 1, 2013, and thus are subject to compliance with the applicable provisions of the Commodity Exchange Act (the "CEA"), and the Commission's regulations thereunder. Many of these CPOs and CTAs are finding compliance with the CFTC's recordkeeping regulations unduly burdensome, indeed infeasible, 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. The Petitioners therefore are requesting, on behalf of their members, that the Commission amend CFTC Regulations 1.31, 4.7(b) and (c), 4.23 and 4.33 and provide the temporary no-action relief as requested herein.

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[4] See *Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations*, 77 Fed. Reg. 11252 (Feb. 24, 2012), amended by *Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations*, 77 Fed. Reg. 17328 (Mar. 26, 2012).

[5] *Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 Fed. Reg. 48208 (Aug. 13, 2012).

II. Electronic Recordkeeping Requirements

The Petitioners fully support the need to ensure that CPOs and CTAs maintain records in a secure, retrievable, and auditable electronic format. We also acknowledge that it is essential to the integrity of the supervisory system to be able to reproduce records, even years after the CPO or CTA created the record, in an "as of" condition (in other words, to be able to retrieve a record with the same content and in the same condition as it existed on the date that the CPO or CTA originally created and/or saved the record to an electronic recordkeeping system).

The Petitioners, however, understand that CPOs and CTAs face technical compliance issues resulting from requirements that were reasonable and prudent when adopted but that have become outdated and irrelevant due to the passage of time and changing technical standards.

A. Background

CFTC Regulation 4.23 sets forth the recordkeeping requirements generally applicable to CPOs registered or required to register under the CEA and CFTC Regulation 4.33 sets forth the recordkeeping requirements generally applicable to CTAs registered or required to register under the CEA. Each of CFTC Regulation 4.23 and 4.33 requires books and records to be maintained in accordance with CFTC Regulation 1.31, which permits electronic recordkeeping subject to certain conditions set forth in CFTC Regulations 1.31(a), (b) and (c).

As a result of the changes to the Part 4 regulations adopted by the CFTC in 2012[6] and the adoption of a broad definition of the types of swaps subject to CFTC regulation,[7] many additional firms are newly subject to compliance with the CPO recordkeeping requirements in Regulation 1.31.

However, Regulation 1.31, as it applies to electronic recordkeeping, is quite outdated. Its obsolete concepts force CPOs and CTAs to choose between accepted electronic distributed storage systems (which are essential for disaster recovery and privacy protection) and compliance with the letter of the law. 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."[8] The outmoded requirements embedded in Regulation 1.31 include the following:

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[6] *See supra*, note 4.

[7] *See supra*, note 5.

[8] *Recordkeeping: Storing Records: SEC & CFTC Harmonization*, 64 Fed. Reg. 28735, at 28736 (May 27, 1999) (hereinafter "1999 Recordkeeping Release"). 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 need to have access to complete and accurate records when necessary."

- CFTC Regulation 1.31(a) requires that electronic records be kept in their native (or original) format. Given that programs sometimes become obsolete and are no longer supported by their manufacturers (for example, WordPerfect, Lotus Notes), we strongly feel that it is counterproductive to specify the "format" of the electronic record, as long as there is demonstrable (and auditable) integrity and fidelity in the preservation of the underlying data and contents.

- CFTC Regulation 1.31(b) requires that electronic records be preserved in a "non-rewritable, non-erasable format," a concept that repeats in CFTC Regulation 1.31(c)'s requirement to represent whether electronic storage records use media other than "optical disk or CD-ROM technology." This requirement mirrors the broader "WORM" ("write once-read many") requirement that was state of the art in the late 1990s and early 2000s. However, the use of optical disks is now a relic of the past and would be indicative of a poorly–managed infrastructure in today's world.[9] Instead, state-of-the-art storage systems rely on storage that is subject to restricted access and include secure logs that reflect any and all changes to a file (often in addition to electronic archived copies).

- In addition, CFTC Regulation 1.31(b) requires firms that use only electronic recordkeeping with respect to some or all of their required records to incur the cost of retaining a third-party technical consultant who has access to, and the ability to download, the firm's electronic records. This third-party technical consultant must file with the Commission an undertaking that, upon request, it will furnish or provide access to information to any representative of the Commission or the U.S. Department of Justice. The purpose of requiring a technical consultant was to ensure that the Commission or other law enforcement had the technical ability to access the records in the event that the recordkeeper was unable or unwilling to provide records.[10] This also is a relic of another age and is simply unworkable; it is not needed in an age where both internal and external technical expertise is common. In addition, CPOs and CTAs are sharing data and access to data with administrators, counterparties, custodians and other service providers, and this dynamic environment ensures that current safeguard systems are broadly adopted and reinforced. Parties in this environment generally are either registered with a governmental entity or are subject to subpoena and preservation orders, which should also ameliorate access and alteration concerns.[11]

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[9] Imagine if the Commission (and its predecessors) over time had required regulated entities to employ wax cylinders, Bakelite records, "78s," "LPs," Dictaphone belts, wire recorders, "45s," 8 track cassettes, audio cassettes, 1960s era hard drives (roughly the size of a home washing machine), RCA video discs, beta tapes, VHS tapes, IBM 360 SXs, Apple Macintoshes, Palm Pilots, or any other specific technology.

[10] *See supra*, note 8. In response to concerns with respect to the costs related to retaining a technical consultant, the Commission stated that registrants could avoid the need for a technical consultant "by maintaining backup copies of electronically stored records in either a hard copy or micrographic version." *Id.* at 28739.

[11] Further, we note that when the Commission adopted these requirements, electronic recordkeeping was considered relatively exotic and the Commission adopted the rules noted to permit electronic recordkeeping but with

Accordingly, as described in further detail below, we respectfully request that the Commission update its electronic recordkeeping regulations applicable to CPOs and CTAs, among other things, to provide more flexibility with regard to permitted formats (both now existing and as yet to be developed) and to eliminate the requirement to retain extraneous, costly, third-party technical consultants.[12]

B. Supporting Arguments

Investment management firms have created and maintained electronic records for years, perhaps approaching two decades for some firms. The relevant provisions in CFTC Regulation 1.31(b) were adopted in 1999,[13] 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. As the Investment Company Institute also noted in its letter requesting relief from various provisions of the CFTC's electronic recordkeeping requirements, converting existing systems (or creating parallel systems) to use non-erasable, non-rewriteable media would require these firms to incur significant costs for new hardware and software, migration of document repositories and staff training.[14] These media and equipment requirements become less available by the day: consumer electronics are now based on solid state memory and cloud storage support and DVD drives are "special order" items.

A reversion to easily misplaced, lost, or stolen physical media is simply out of step with the industry and presents significant challenges to a firm trying to maintain a robust disaster recovery/BCP plan program. Strict adherence to CFTC 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. The new focus on hacking and cybersecurity only further demonstrates the need to be able to remotely restore files and functionality – sometimes (unfortunately) in real time in an active trading environment.

In addition, firms must incur the wholly unnecessary cost to retain and train a third-party technical consultant, rather than relying upon existing staff who already have familiarity with

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an abundance of caution. Today, it is inconceivable that any business would keep records by any means other than electronic media. Indeed, a CPO or CTA that uses paper ledgers, typewriters, and carbon paper would be unlikely to maintain accurate records and probably would be more able to falsify and alter records than is possible with the modern means of electronic recordkeeping noted above.

[12] One of the Commission's goals in the 1999 Recordkeeping Release was "maximize[ing] the cost-reduction and time-savings arising from technological developments in the area of electronic storage media." 1999 Recordkeeping Release at 28735, *supra* note 8.

[13] *Id.*

[14] *See* Petition for Rulemaking to Amend CFTC Regulations 4.12(c)(3), 4.23 and 4.33 from Dorothy M. Donohue, Acting General Counsel, Investment Company Institute, to Ms. Melissa D. Jurgens, Secretary, Commodity Futures Trading Commission, dated March 11, 2014.

and access to required records. In the "new world" of electronic storage of the 1990s and 2000s, when technical expertise was not common, this requirement may have made sense. However, in today's world, with sophisticated National Futures Association (the "NFA"), CFTC, and even SEC examination personnel and programs, robust retention systems, and very extensive investor due diligence, such an expense would be wasteful and of little value. Moreover, with the rise of cybersecurity threats, providing additional third parties with access to sensitive, confidential and proprietary information greatly increases cybersecurity intrusions.

Alternatively, if firms determine that they cannot comply with these requirements, such firms must take the time-consuming, costly and old-fashioned step of preserving records in hard copies or micrographics, solely for purposes of compliance with CFTC Regulation 1.31(b).[15] This is simply not possible to do in any way that would enable the variable-based searching that any regulatory inquiry or legal process requires.[16]

These issues could be resolved if CFTC Regulation 1.31 provided a more adaptable approach toward technology and permitted various types of recordkeeping formats (whether now existing or as yet to be developed).

For example, the SEC took the approach of providing flexibility when it tailored its recordkeeping rule applicable to investment advisers by adopting Rule 204-2(g) under the Investment Advisers Act of 1940, as amended (the "Advisers Act").[17] By adopting different recordkeeping requirements for advisers, as compared to those applicable to broker-dealers,[18] the

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[15] The 1999 Recordkeeping Release, *supra* note 8, provides that:

> Recordkeepers are only required to enter an arrangement with a Technical Consultant if they choose to store all required records or all of a particular class of required records solely on electronic storage media. As a result, recordkeepers may protect themselves from costs related to retaining a Technical Consultant by maintaining backup copies of electronically stored records in either a hard copy or micrographic version.

[16] *See, e.g.,* CFTC Regulation 1.35(a), records of commodity interest and related cash or forward transactions, which requires records to "be kept in a form and manner identifiable and searchable by transaction."

[17] Ironically, one of the reasons the Commission indicated that it was adopting provisions similar to the SEC's recordkeeping provisions was because of the significant number of dual registrants. *See* 1999 Recordkeeping Release, *supra* note 13. The SEC's recordkeeping requirements for investment advisers were adopted subsequent to the 1999 Recordkeeping Release.

[18] Current CFTC Regulation 1.31(b) was modeled on Rule 17a-4(f) under the Securities Exchange Act of 1934, as amended, the SEC's electronic recordkeeping rule for broker-dealers. *Recordkeeping*, 64 Fed. Reg. 28735, at 28735 (May 27, 1999) ("In light of the significant number of Commission registrants that are subject to the recordkeeping requirements of the [SEC], the Proposal included many provisions similar to those adopted by the SEC in 1997.") The SEC later adopted a separate electronic recordkeeping rule for investment advisers, which differs significantly from Rule 17a-4(f), as discussed below. *See Electronic Recordkeeping by Investment Companies and Investment Advisers*, 66 Fed. Reg. 29224 (May 30, 2001) ("Electronic Records Adopting Release"), which announced amendments to SEC Regulation 275.204-2(g). However, the Commission applied Regulation 1.31(b) to all registrants, rather than only to futures commission merchants and introducing brokers (whose business models are somewhat similar to broker-dealers).

SEC explicitly stated that the cost of requiring advisers to adopt non-rewriteable, non-erasable formats of electronic records may not be justified.[19] Rule 204-2(g) does not tether advisers to any particular electronic format, nor does it require the use of third-party consultants. Instead, Rule 204-2(g) sets forth general principles that advisers must follow when arranging, accessing and reproducing their records. A principles-based approach facilitates adaptable recordkeeping requirements that can withstand evolutions in technology and software. In contrast, specifying the format of an electronic record inevitably will lead to obstacles to compliance at some point in the future when that format becomes obsolete and is no longer supported by its manufacturer (again, for example, Word Perfect).

Further, the burden of maintaining and producing required records under Rule 204-2(g) logically falls on the registered adviser itself, rather than any third parties who likely would charge a premium to subject themselves to such regulatory obligations. The current requirements of CFTC Regulation 1.31 to utilize native format and a third-party technical consultant appear to be intended both to preserve records without alteration and to ensure access to such records. However, technology has evolved, and today there are other safeguards to ensure the integrity and availability of data. Technological expertise is much more widely available today than it was fifteen years ago. Experts can readily determine whether and how records have been altered, and these experts are well-equipped to obtain access to various computer systems. The need for a third-party technical consultant has fallen away as technological expertise has become woven into our everyday lives.

As the Commission acknowledged in its release regarding harmonization of compliance obligations for operators of registered investment companies that also must register as CPOs, there are certain advantages to crafting regulations that "allow the Commission to fulfill its regulatory mandate while, at the same time, avoiding unnecessary regulatory burdens on dually-regulated [entities] with respect to … Commission recordkeeping requirements."[20] We believe that the Commission's objectives with respect to electronic recordkeeping requirements by CPOs and CTAs can be satisfied with provisions substantially similar to Rule 204-2(g). Moreover, structuring a CFTC recordkeeping rule to be consistent with the SEC's recordkeeping rule for investment advisers would be consistent with the Commission's original goal in the 1999

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[19] In its adoption of electronic recordkeeping standards for funds and advisers, the SEC noted:

> We recognize that the standards for electronic recordkeeping we are adopting for funds and advisers are different from the rules that we have adopted for broker-dealers, which require brokerage records to be preserved in a WORM format [(*i.e.*, non-rewriteable, non-erasable or "write once, read many," format)]. We have not experienced any significant problems with funds or advisers altering stored records. Moreover, most advisory and mutual fund arrangements involve multiple parties (e.g., brokers, custodians, transfer agents), each with its own, often parallel, recordkeeping requirement. As a result, our compliance examiners typically have an alternative means to verify the accuracy of adviser and fund records. In light of these factors, the costs of requiring funds and advisers to invest in new electronic recordkeeping technologies may not be justified.

Electronic Records Adopting Release, *supra* note 18, at 29224.

[20] *See Harmonization of Compliance Obligations for Registered Investment Companies Required to Register as Commodity Pool Operators*, 78 Fed. Reg. 52308 at 52309 (Aug. 22, 2013).

Recordkeeping Release to align with similar SEC changes and "thereby harmonizing procedures for those firms regulated by both the Commission and the [SEC]." To the Petitioners' knowledge, the SEC has not experienced difficulties in obtaining the electronic records of investment advisers since the rule's adoption in 2001.

C. Requested Relief

The Petitioners hereby respectfully request that the Commission adopt new Regulation 1.31(e) (the full text of which can be found in Appendix A), which would apply to all CPOs and CTAs registered or required to register under the CEA (in lieu of Regulations 1.31(b) and (c)) and would substantially mirror Rule 204-2(g) under the Advisers Act. Regulation 1.31(e) would permit a CPO or CTA to maintain records on (i) micrographic media, including microfilm, microfiche or any similar medium; or (ii) electronic media, including any electronic medium or system or cloud technology that otherwise meets applicable recordkeeping requirements. Generally, the CPO or CTA must (i) arrange and index the records in a way that permits easy location, access and retrieval of any particular record; (ii) promptly provide a legible, true and complete copy of any record either in the medium and format in which it is stored (or a printout), as well as the means to access, view and print the record; and (iii) separately store a duplicate copy of the records in any permitted medium for the required length of time.

Additionally, with respect to electronic media, the CPO or CTA must establish and maintain procedures to: (i) maintain and preserve the records, so as to reasonably safeguard them from loss, alteration or destruction; (ii) limit access to the records to properly authorized personnel and the Commission (including its examiners and other representatives); and (iii) reasonably ensure that any reproduction of a non-electronic original record on electronic media is complete, true and legible when retrieved. Regulation 1.31(a) will continue to apply to CPOs and CTAs and require, among other things, that such records be open to inspection by the Commission or the U.S. Department of Justice and that such records will be produced to a CFTC representative upon request. The records will also be available for inspection by representatives of the NFA.

III. Expansion of Third-Party Recordkeeping for All CPOs

A. Background

Current CFTC Regulations permit delegation of recordkeeping by CPOs only to certain third parties and further require such third-party recordkeepers to comply with Regulation 1.31. Specifically, Regulation 4.23 permits CPOs to utilize only third-party recordkeepers that serve as the pool's administrator, distributor or custodian, or a bank or registered broker-dealer acting in a similar capacity with respect to the pool. In addition, Regulation 4.23(c)(2) requires such third-party recordkeeper to certify that it will keep and maintain the records in compliance with CFTC Regulation 1.31. Regulation 4.7(b) sets forth identical third-party recordkeeping requirements for CPOs who rely upon the limited regulatory relief therein.

As a result of the changes to the Part 4 regulations adopted by the CFTC in 2012[21] and the adoption of a broad definition of the types of swaps subject to CFTC regulation,[22] many additional firms are newly subject to compliance with the CPO recordkeeping requirements in Regulations 4.23 or 4.7(b). The requirement to renegotiate contracts with existing recordkeepers or to find new recordkeepers that fall within the categories of permitted recordkeepers and that are willing to subject themselves to compliance with Regulation 1.31 is a significant, expensive burden. Accordingly, as described in further detail below, we respectfully request that the Commission expand third-party recordkeeping requirements to permit a CPO or CTA to use any third-party to retain such records and to eliminate the duplicative requirement that a third-party recordkeeper (in addition to the registered CPO or CTA) certify that they keep and maintain records in accordance with Regulation 1.31.

B. Supporting Arguments

The Petitioners understand that many of their members are having difficulty finding recordkeepers that fall within the permitted categories and that are willing to subject themselves to compliance with Regulation 1.31 (as discussed below). Many of these firms have existing relationships with third-party recordkeepers, some of whom do not fall within the categories of permitted recordkeepers under Regulations 4.23 or 4.7(b), such as CTAs and sub-advisers, futures commission merchants and professional records maintenance and storage companies. In addition, the process of changing a recordkeeper is labor-intensive and costly, since often many physical records must be manually moved to the new recordkeeper's recordkeeping infrastructure. We note that the CFTC places no restrictions on who may act as a recordkeeper for a futures commission merchant or introducing broker, and we are unaware of any issues that the CFTC or NFA has experienced as a result.

With respect to the requirement for currently permitted third-party recordkeepers to certify that they are maintaining records in compliance with Regulation 1.31, existing contracts with these recordkeepers, particularly professional records maintenance and storage companies, typically do not require such companies to maintain records in a manner other than that in which the records have been supplied. Renegotiating these contracts likely would result in significantly increased costs to compensate the companies for increased responsibilities and potential liabilities under CFTC Regulation 1.31; in fact, renegotiation may be impossible because these companies are reluctant to undertake these responsibilities and potential liabilities. Accordingly, even utilizing the narrow universe of permitted third-party recordkeepers under CFTC Regulations 4.23 or 4.7(b) is unduly burdensome and costly. The burden of complying with Regulation 1.31 logically should fall on the registered CPO itself, rather than any third parties, which likely would charge a premium to subject themselves to such regulatory obligations. By requiring the CPO to bear responsibility for maintaining and producing required records, we

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[21] *See supra*, note 4.

[22] *See supra*, note 5.

believe that the Commission's objectives can be satisfied while accommodating current appropriate market practices with respect to the use of third-party recordkeepers.[23]

C. Requested Relief

The Petitioners hereby respectfully request that the Commission revise Regulations 4.23 and 4.7(b)(4) to eliminate the requirement that records be maintained only with specified categories of third parties (the pool's administrator, distributor or custodian, or a bank or registered broker-dealer acting in a similar capacity with respect to the pool), instead permitting CPOs to utilize any third-party recordkeeper.[24] In addition, the Petitioners request that the Commission revise Regulations 4.23(c)(2) and 4.7(b)(5) to eliminate the requirement that third-party recordkeepers certify that they keep and maintain records in accordance with Regulation 1.31. In our proposal, the CPO will retain responsibility under Regulation 1.31 for compliance thereunder. The full text of the proposed revisions to Regulation 4.23 and Regulation 4.7(b) can be found in Appendix A attached hereto.

IV. Expansion of Third-Party Recordkeeping to CTAs

A. Background

Neither Regulation 4.33 nor Regulation 4.7(c) permits delegation of recordkeeping by CTAs to third parties. Many additional firms are newly subject to compliance with the CTA recordkeeping requirements in CFTC Regulations 4.33 or 4.7(c) as a result of the changes to the Part 4 regulations adopted by the CFTC in 2012[25] and the adoption of the broad definition of the types of swaps subject to CFTC regulation.[26] Many of these firms have existing relationships with third-party recordkeepers, including professional records maintenance and storage companies. Requiring these firms to terminate third-party recordkeeping arrangements and to manage all record-keeping internally would be a significant, expensive burden that simply may not be practicable for certain registrants. Accordingly, we respectfully request that the Commission revise third-party recordkeeping requirements to permit CTAs to use third-party recordkeepers, as described in further detail below.

B. Supporting Arguments

We believe that CTAs should be granted the same third-party recordkeeping relief described above with respect to CPOs. Currently, CTAs are not permitted to rely on third-party

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[23] Also, we note that this accommodates technological developments to enhance safeguards with respect to the recordkeeping process, such as the current trend to move to cloud computing.

[24] Contrast a third-party recordkeeper, as described above, with a third-party technical consultant, which is required by current CFTC Regulation 1.31(b)(4) to furnish the registrant's electronic records to the CFTC or the Department of Justice if the CPO is unwilling or able to do so.

[25] *See supra*, note 4.

[26] *See supra*, note 5.

recordkeepers at all. Many firms that are newly registered with the CFTC have existing relationships with third-party recordkeepers, including with professional records maintenance and storage companies and with affiliates. Rearranging internal operations and terminating these contracts is unduly burdensome and costly. In addition, we do not believe that there is any policy reason to treat CPOs and CTAs substantially differently with respect to the use of third-party recordkeepers. We believe that the Commission's objectives can be satisfied while expanding the use of third-party recordkeepers to CTAs in order to accommodate current market practices. As noted above, the CFTC places no restrictions on who may act as a recordkeeper for a futures commission merchant or introducing broker, and we are unaware of any issues that the CFTC or NFA has experienced as a result.

C. Requested Relief

The Petitioners hereby respectfully request that the Commission revise Regulation 4.33 to permit CTAs to utilize third-party recordkeepers, the relevant language of which would be substantially similar to Regulation 4.23 (including the revisions proposed above). The Petitioners also request that the Commission revise Regulation 4.7(c)(2) to permit CTAs in reliance upon such exemption to utilize third-party recordkeepers. The full text of the proposed revisions to Regulation 4.33 and Regulation 4.7(c)(2) can be found in Appendix A attached hereto.

V. Temporary No-Action Relief

The Petitioners acknowledge that it will take time for the Commission to give its full consideration to this request and to conduct a further rulemaking. For this reason, the Petitioners also request temporary no-action relief, which would allow the Commission adequate time to fully consider these requests while sparing CPOs and CTAs (and their third-party recordkeepers) from having to modify long-standing recordkeeping arrangements and systems. We request that this temporary no-action relief exempt all CPOs and CTAs from compliance with CFTC Regulation 1.31(b) and (c) as well as from compliance with provisions of CFTC Regulations 4.7(b) and (c), 4.23 and 4.33 relating only to third-party recordkeeping until the effective date of the further rulemaking; provided that CPOs and CTAs maintain the types of records required to be maintained under CFTC Regulation 4.23 or CFTC Regulation 4.33, as applicable, for the required length of time specified by CFTC Regulation 1.31(a) in a manner that preserves the text of the original record.

VI. Conclusion

The Commission's regulations concerning electronic recordkeeping were adopted nearly fifteen years ago, and there have been revolutionary changes in technology since such time. We respectfully request that the Commission adopt the amendments to CFTC Regulations 1.31, 4.7(b) and (c), 4.23 and 4.33 as set forth in Appendix A. Specifically, we respectfully request that the Commission update its electronic recordkeeping regulations to eliminate outdated, unnecessary requirements. We respectfully submit that CPOs and CTAs have evolved with such changes in technology, in part by hiring knowledgeable employees who are already familiar with

and who already have access to their electronic recordkeeping systems. We urge the Commission to adopt a standards-based recordkeeping requirement that places the responsibility for maintaining accurate records on the CPO and CTA. Further we believe that specifying specific technology in a rule is ultimately self-defeating. Accordingly, we respectfully request that the Commission eliminate the requirement to retain extraneous, costly, third-party technical consultants. On a different but related note, we respectfully request that the Commission expand third-party recordkeeping requirements to permit a CPO or CTA to use any third-party to retain such records and to eliminate outdated requirements for such third parties. We respectfully submit that the Commission's objectives can be satisfied by requiring the CPO or CTA to bear all responsibility for maintaining and producing records pursuant to the Commission's regulations.

The Petitioners also respectfully request temporary expedited no-action relief in this regard, to last until final rules relating to this petition are adopted and effective.

* * * *

We sincerely appreciate the Commission's willingness to address the industry's concerns. If you have questions or require further information, please contact Jennifer Han or Stuart Kaswell of MFA at (202) 730-2600, Karen Barr of IAA at (202) 293-4222, and Jiří Król of AIMA at +44 (0)20 7822 8380, or our outside counsel at K&L Gates, Cary J. Meer at (202) 778-9107.

Respectfully submitted,

/s/ Stuart Kaswell

Stuart Kaswell
General Counsel
Managed Funds Association

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Investment Adviser Association

Jiří Król
Deputy CEO
Head of Governmental and Regulatory Affairs
Alternative Investment Management Association

cc: Clark Ogilvie, Chief of Staff, Office of Chairman Massad
Lawranne Stewart, Interim Senior Counsel, Office of Chairman Massad
Bella Rozenberg, Legal Counsel, Office of Commissioner O'Malia
Scott Reinhart, Special Counsel and Policy Advisor, Office of Commissioner Wetjen
Mark Fajfar, Interim Senior Advisor-Counsel, Office of Commissioner Bowen
Marcia Blase, Senior Counsel, Office of Commissioner Giancarlo
Gary Barnett, Director, and Amanda Olear, Associate Director
Division of Swap Dealer and Intermediary Oversight
Jonathan Marcus, General Counsel
Aitan Goelman, Director, Division of Enforcement
Vincent McGonagle, Director of the Division of Market Oversight
Cory Claussen, Director of Legislative Affairs

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Respectfully submitted,

Stuart Kaswell General Counsel Managed Funds Association	Karen Barr General Counsel Investment Adviser Association	Jiří Król Deputy CEO Head of Governmental and Regulatory Affairs Alternative Investment Management Association

cc: Clark Ogilvie, Chief of Staff, Office of Chairman Massad
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APPENDIX A

Text of Proposed Rule Amendments

Additions to current regulations in *bold italics and underlined*. Deletions in ~~strikethrough~~.

§1.31 **Books and records; keeping and inspection.**

(a)(1) All books and records required to be kept by the Act or by these regulations shall be kept in their original form (for paper records) or ***such other media permitted under this section as long as the contents of the original record are preserved*** ~~native file format~~ (for electronic records) for a period of five years from the date thereof and shall be readily accessible during the first 2 years of the 5-year period; *Provided, however*, That records of any swap or related cash or forward transaction shall be kept until the termination, maturity, expiration, transfer, assignment, or novation date of the transaction and for a period of five years after such date. Records of oral communications kept pursuant to §§1.35(a) and 23.202(a)(1) and (b)(1) of this chapter shall be kept for a period of one year. All such books and records shall be open to inspection by any representative of the Commission, or the United States Department of Justice. ~~For purposes of this section, native file format means an electronic file that exists in the format in which it was originally created.~~

* * *

(b) Except as provided in paragraph***s*** (d) ***and (e)*** of this section, books and records required to be kept by the Act or by these regulations may be stored on either "micrographic media" (as defined in paragraph (b)(1)(i) of this section) or "electronic storage media" (as defined in paragraph (b)(1)(ii) of this section) for the required time period under the conditions set forth in this paragraph (b); Provided, however, For electronic records, such storage media must ***be*** preserve***d*** ~~the native file format of the electronic records~~ as required by paragraph (a)(1) of this section.

* * *

(c) ***Except as provided in paragraph (e) of this section,*** ~~P~~***p***ersons employing an electronic storage system shall provide a representation to the Commission prior to the initial use of the system. The representation shall be made by the person required to maintain the records, the storage system vendor, or another third party with appropriate expertise and shall state that the selected electronic storage system meets the requirements set forth in paragraph (b)(1)(ii) of this section. Persons employing an electronic storage system using media other than optical disk or CD-ROM technology shall so state. The representation shall be accompanied by the type of oath or affirmation described in §1.10(d)(4).

(d) * * *

(e)(1) In lieu of complying with paragraphs (b) and (c) of this section, any commodity pool operator registered or required to be registered under the Act or any commodity trading

advisor registered or required to be registered under the Act may comply with this paragraph (e). Any registered commodity pool operator or any registered commodity trading advisor may maintain and preserve books and records required to be kept by the Act or by these regulations (i) on paper, (ii) on micrographic media, including microfilm, microfiche, or any similar medium; or (iii) on electronic media, including any electronic medium or environment that meets the terms of this paragraph, as long as the contents of the original record are preserved.

(*2) To comply with this paragraph (e), the commodity pool operator registered or required to be registered under the Act or the commodity trading advisor registered or required to be registered under the Act must:*

(i) Arrange and index the records in a way that permits easy location, access, and retrieval of any particular record;

(ii) Provide promptly any of the following that the Commission or a registered futures association (by its examiners or other representatives) may request:

(A) A legible, true, and complete copy of the record in the medium and format in which it is stored;

(B) A legible, true, and complete printout of the record; and

(C) Means to access, view, and print the records; and

(iii) Separately store, for the time required for preservation of the original record, a duplicate copy of the record on any medium allowed by this paragraph.

(3) In the case of records on electronic media, the commodity pool operator or commodity trading advisor must establish and maintain procedures to:

(i) Maintain and preserve the records, so as to reasonably safeguard them from loss, alteration, or destruction;

(ii) Limit access to the records to properly authorized personnel, the Commission or a registered futures association (including its examiners and other representatives) and other appropriate regulators and self-regulatory organizations; and

(iii) Reasonably ensure that any reproduction of a non-electronic original record on electronic media is complete, true, and legible when retrieved.

* * * * *

§4.7 **Exemption from certain part 4 requirements for commodity pool operators with respect to offerings to qualified eligible persons and for commodity trading advisors with respect to qualified eligible persons.**

(a) * * *

(b) Relief available to commodity pool operators. * * *

(1) * * *

(2) * * *

(3) * * *

(4) *Recordkeeping relief.* Exemption from the specific requirements of §~~4,23~~ ***4.23***; Provided, That the commodity pool operator must maintain the reports referred to in paragraphs (b)(2) and (3) of this section and all books and records prepared in connection with his activities as the pool operator of the exempt pool (including, without limitation, records relating to the qualifications of qualified eligible persons and substantiating any performance representations). Books and records that are not maintained at the pool operator's main business office ~~shall~~ ***may*** be maintained by ~~one or more of the following: the pool's administrator, distributor or custodian, or a bank or registered broker or dealer acting in a similar capacity with respect to the pool~~ ***a third party***. Such books and records must be made available to any representative of the Commission, the National Futures Association and the United States Department of Justice in accordance with the provisions of §1.31.

(5) If the pool operator does not maintain its books and records at its main business office, the pool operator shall~~: (i) A.~~***, a***t the time it registers with the Commission or delegates its recordkeeping obligations ***or [insert 180 days after the change to this rule]***, whichever is later, file a statement that:

(~~A~~***i***) Identifies the name, main business address, and main business telephone number of the person(s) who will be keeping required books and records in lieu of the pool operator;

(~~B~~***ii***) Sets forth the name and telephone number of a contact for each person who will be keeping required books and records in lieu of the pool operator;

(~~C~~***iii***) Specifies~~, by reference to the respective paragraph of this section,~~ the books and records that such person will be keeping; and

(~~D~~***iv***) Contains representations from the pool operator that:

(~~1~~***A***) It will promptly amend the statement if the contact information or location of any of the books and records required to be kept by this section changes, by identifying in such amendment the new location and any other information that has changed;

(~~2~~***B***) It remains responsible for ensuring that all books and records required by this section are kept in accordance with §1.31;

(~~3~~***C***) Within 48 hours after a request by a representative of the Commission, it will obtain the original books and records from the location at which they are maintained, and provide them for inspection at the pool operator's main business office; Provided, however, that if the original books and records are permitted to be, and are maintained, at a location outside the United States, its territories or possessions, the pool operator will obtain and provide such original books and records for inspection at the pool operator's main business office within 72 hours of such a request; and

(~~4~~***D***) It will disclose in the pool's Disclosure Document the location of its books and records that are required under this section.

~~(ii) The pool operator shall also file electronically with the National Futures Association a statement from each person who will be keeping required books and records in lieu of the pool operator wherein such person:~~

~~(A) Acknowledges that the pool operator intends that the person keep and maintain required pool books and records;~~

~~(B) Agrees to keep and maintain such records required in accordance with §1.31 of this chapter; and~~

~~(C) Agrees to keep such required books and records open to inspection by any representative of the Commission, the National Futures Association, or the United States Department of Justice in accordance with §1.31 of this chapter.~~

(c) *Relief available to commodity trading advisors.* * * *

(1) * * *

(2) *Recordkeeping relief.* Exemption from the specific requirements of §4.33; Provided, That the commodity trading advisor must maintain, at its main business office, all books and records prepared in connection with his activities as the commodity trading advisor of qualified eligible persons (including, without limitation, records relating to the qualifications of such qualified eligible persons and substantiating any performance representations). ***Books and records that are not maintained at the commodity trading advisor's main business office may be maintained by a third party***. ~~And must make s~~ ***S***uch books and records ***must be made*** available to any representative of the Commission, the National Futures Association and the United States Department of Justice in accordance with the provisions of §1.31.

(3) If the commodity trading advisor does not maintain its books and records at its main business office, the commodity trading advisor shall, at the time it registers with the Commission or delegates its recordkeeping obligations or [insert 180 days after the change to this rule], whichever is later, file a statement that:

(i) Identifies the name, main business address, and main business telephone number of the person(s) who will be keeping required books and records in lieu of the commodity trading advisor;

(ii) Sets forth the name and telephone number of a contact for each person who will be keeping required books and records in lieu of the commodity trading advisor;

(iii) Specifies the books and records that such person will be keeping; and

(iv) Contains representations from the commodity trading advisor that:

(A) It will promptly amend the statement if the contact information or location of any of the books and records required to be kept by this section changes, by identifying in such amendment the new location and any other information that has changed;

(B) It remains responsible for ensuring that all books and records required by this section are kept in accordance with §1.31; and

(C) Within 48 hours after a request by a representative of the Commission, it will obtain the original books and records from the location at which they are maintained, and provide them for inspection at the commodity trading advisor's main business office; Provided, however, that, if the original books and records are permitted to be, and are maintained, at a location outside the United States, its territories or possessions, the commodity trading advisor will obtain and provide such original books and records for inspection at the commodity trading advisor's main business office within 72 hours of such a request.

(d) * * *

§4.23 **Recordkeeping.**

Each commodity pool operator registered or required to be registered under the Act must make and keep the following books and records in an accurate, current and orderly manner. Books and records that are not maintained at the pool operator's main business office ~~shall~~ ***may*** be maintained by ~~one or more of the following: the pool's administrator, distributor or custodian, or a bank or registered broker or dealer acting in a similar capacity with respect to the pool~~ ***a third party***. All books and records shall be maintained in accordance with §1.31. All books and records required by this section except those required by paragraphs (a)(3), (a)(4), (b)(1), (b)(2) and (b)(3) must be made available to participants for inspection and copying during normal business hours. Upon request, copies must be sent by mail to any participant within five business days if reasonable reproduction and distribution costs are paid by the pool participant. If the books and records are maintained at the commodity pool operator's main business office that is outside the United States, its territories or possessions, then upon the request of a Commission representative, the pool operator must provide such books and records as requested at the place

in the United States, its territories or possessions designated by the representative within 72 hours after the pool operator receives the request.

* * *

(b) * * *

(c) If the pool operator does not maintain its books and records at its main business office, the pool operator shall~~: (1) A~~***, a***t the time it registers with the Commission or delegates its recordkeeping obligations, whichever is later, file a statement that:

(~~i~~***1***) Identifies the name, main business address, and main business telephone number of the person(s) who will be keeping required books and records in lieu of the pool operator;

(~~ii~~***2***) Sets forth the name and telephone number of a contact for each person who will be keeping required books and records in lieu of the pool operator;

(~~iii~~***3***) Specifies~~, by reference to the respective paragraph of this section,~~ the books and records that such person will be keeping; and

(~~iv~~***4***) Contains representations from the pool operator that:

(~~A~~***i***) It will promptly amend the statement if the contact information or location of any of the books and records required to be kept by this section changes, by identifying in such amendment the new location and any other information that has changed;

(~~B~~***ii***) It remains responsible for ensuring that all books and records required by this section are kept in accordance with §1.31;

(~~C~~***iii***) Within 48 hours after a request by a representative of the Commission, it will obtain the original books and records from the location at which they are maintained, and provide them for inspection at the pool operator's main business office; Provided, however, that if the original books and records are permitted to be, and are maintained, at a location outside the United States, its territories or possessions, the pool operator will obtain and provide such original books and records for inspection at the pool operator's main business office within 72 hours of such a request; and

(~~D~~***iv***) It will disclose in the pool's Disclosure Document the location of its books and records that are required under this section.

~~(2) The pool operator shall also file electronically with the National Futures Association a statement from each person who will be keeping required books and records in lieu of the pool operator wherein such person:~~

~~(i) Acknowledges that the pool operator intends that the person keep and maintain required pool books and records;~~

~~(ii) Agrees to keep and maintain such records required in accordance with §1.31 of this chapter; and~~

~~(iii) Agrees to keep such required books and records open to inspection by any representative of the Commission or the United States Department of Justice in accordance with §1.31 of this chapter and to make such required books and records available to pool participants in accordance with this section.~~

§4.33 **Recordkeeping.**

Each commodity trading advisor registered or required to be registered under the Act must make and keep the following books and records in an accurate, current and orderly manner ~~at its main business office and~~ ~~in accordance with §1.31.~~ ***Books and records that are not maintained at the pool operator's main business office may be maintained by a third party. All books and records shall be maintained in accordance with §1.31.*** If the commodity trading advisor's main business office is located outside the United States, its territories or possessions, then upon the request of a Commission representative the trading advisor must provide such books and records as requested at the place designated by the representative in the United States, its territories or possessions within 72 hours after receipt of the request.

(a) * * *

(b) * * *

(c) If the commodity trading advisor does not maintain its books and records at its main business office, the commodity trading advisor shall, at the time it registers with the Commission or delegates its recordkeeping obligations or [insert 180 days after the change to this rule], whichever is later, file a statement that:

(1) Identifies the name, main business address, and main business telephone number of the person(s) who will be keeping required books and records in lieu of the commodity trading advisor;

(2) Sets forth the name and telephone number of a contact for each person who will be keeping required books and records in lieu of the commodity trading advisor;

(3) Specifies the books and records that such person will be keeping; and

(4) Contains representations from the commodity trading advisor that:

(i) It will promptly amend the statement if the contact information or location of any of the books and records required to be kept by this section changes, by identifying in such amendment the new location and any other information that has changed;

(ii) It remains responsible for ensuring that all books and records required by this section are kept in accordance with §1.31; and

(iii) Within 48 hours after a request by a representative of the Commission, it will obtain the original books and records from the location at which they are maintained, and provide them for inspection at the commodity trading advisor's main business office; Provided, however, that, if the original books and records are permitted to be, and are maintained, at a location outside the United States, its territories or possessions, the commodity trading advisor will obtain and provide such original books and records for inspection at the commodity trading advisor's main business office within 72 hours of such a request.

June 9, 2014

The Honorable Daniel M. Gallagher
Commissioner
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Investment Adviser Examinations

Dear Commissioner Gallagher:

On behalf of the Investment Adviser Association,[1] I am writing to highlight our views on the subject of investment adviser examinations and to express our willingness to engage in discussions with you to examine the relative merits of appropriate options to enhance investment adviser oversight.

Based on your recent remarks at the Rocky Mountain Securities Conference[2] and the Financial Industry Regulatory Authority (FINRA) Annual Conference, you share our concern that the SEC's current program does not examine sufficient numbers of SEC-registered investment advisers each year. We have a long history of supporting efforts to increase the frequency of investment adviser examinations. To that end, we have emphasized that the most cost-effective and appropriate approach is to enhance the Commission's own examination program.[3] For example, in our testimony before the House Financial Services Committee in 2012, we stated that: "[t]he SEC, a governmental regulator that is accountable to Congress and the public, has more than seven decades of experience and expertise regulating and inspecting investment advisers"…and "is best-positioned to provide effective oversight for all SEC-registered investment advisers, irrespective of asset size and type of clients served."[4] As part of

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[1] The Investment Adviser Association is a not-for-profit association that represents the interests of investment adviser firms registered with the Securities and Exchange Commission. Founded in 1937, the IAA's membership consists of more than 550 advisory firms that collectively manage approximately $14 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations. For more information, please visit our website: www.investmentadviser.org.

[2] Daniel M. Gallagher, Commissioner, *Remarks at the 46th Annual Rocky Mountain Securities Conference* (May 9, 2014).

[3] Frequency of examinations is important, but it is only part of the equation. Examinations must be effective, substantive, risk-targeted, and conducted by examiners who understand both relevant regulation and the nature of the businesses being examined.

[4] Testimony of David G. Tittsworth, Executive Director, IAA, before the House Committee on Financial Services (June 6, 2012), available at: https://www.investmentadviser.org/eweb/docs/Publications_News/Comments_and_Statements/Current_Comments_Statements/120606tstmny.pdf.

the SEC, the Office of Compliance Inspections and Examinations (OCIE) can fully utilize specialized internal resources. For example, as noted by Chair White, OCIE's Office of Risk Assessment and Surveillance "aggregates and analyzes a broad band of data to identify potentially problematic behavior," and "is developing exciting new technologies – text analytics, visualization, search, and predictive analytics – to cull additional red flags from internal and external data and information resources."[5] In addition, OCIE can draw on the unique regulatory and policy expertise of the SEC's Division of Investment Management and the risk identification capabilities of the Division of Economic and Risk Analysis.

We strongly supported the SEC's recent request to add 250 examiners to its investment adviser/investment company oversight program. While OCIE has made significant progress in improving its investment adviser examination program, the additional resources requested by the SEC would have enabled the agency to increase the frequency of investment adviser examinations. Unfortunately, the FY 2014 appropriations bill adopted by Congress did not provide the SEC with funds to hire these additional examiners.

We also have favored legislation that would authorize the Commission to impose user fees on investment advisory firms that would be solely dedicated to enhancing the SEC's investment adviser oversight program. We have expressed support for H.R. 1627, the "Investment Adviser Examination Improvement Act of 2013." In a joint letter to members of the House of Representatives, we noted that:[6]

> Quantitative analysis supports the position that a user fee is the most effective and efficient way to pay for improved investment adviser oversight. The Boston Consulting Group, Inc. conducted a study (BCG Study) that determined that a user fee is the least expensive of the options set forth in the Section 914 Study, in part, because it would not require the SEC to allocate additional resources to oversee an SRO. Further, the BCG Study found that an SRO would cost at least twice as much as funding an enhanced SEC examination program paid for through user fees.
>
> The BCG Study found that a user fee enjoys broad industry support. The survey found that:

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[5] Mary Jo White, Chair, *The SEC in 2014* (Jan. 27, 2014). Chair White also stated that these tools "will help our examiners be even more efficient and effective in analyzing massive amounts of data to more quickly and accurately hone in on areas that pose the greatest risks and warrant further investigation. In an era of limited resources and expanding responsibilities, it is essential to identify and target these risks more systematically. And we are doing that." She identified a specific initiative in February 2014, the National Exam Analytics Tool (NEAT), and noted that this tool recently analyzed 17 million transactions executed by one investment adviser in 36 hours. Mary Jo White, Chair, *Remarks at the "SEC Speaks" Conference* (Feb. 21, 2014).

[6] Letter from AARP, Consumer Federation of America, Financial Planning Coalition, IAA, and North American Securities Administrators Association to U.S. House of Representatives in Support of H.R. 1627, the Investment Adviser Examination Improvement Act of 2013 (Dec. 4, 2013), available at https://www.investmentadviser.org/eweb/docs/Publications_News/Comments_and_Statements/Current_Comments_Statements/131204cmnt.pdf.

- approximately 81% of investment advisers said they preferred the SEC over FINRA oversight; and
- the preference for SEC oversight remained strong even if it would cost investment advisers more than FINRA oversight.

At the same time, we have consistently voiced our objections to extending FINRA's examination or rulemaking authority to investment advisory firms. As stated in our 2012 testimony, "[w]e particularly oppose extending FINRA's jurisdiction to investment advisers due to its lack of transparency and accountability, questionable track record, the costs involved, and its experience and bias favoring the broker-dealer regulatory model." FINRA does not have the expertise or experience to examine investment advisers. In light of these and other concerns – which have been voiced by many disparate interests (including the CATO Institute, U.S. Chamber of Commerce, and North American Securities Administrators Association) – we believe it would be a mistake to outsource the SEC's investment adviser examination program to FINRA.

Your May 9 speech posits that the Commission is not finding misconduct by investment advisers as quickly as it finds misconduct by broker-dealers "because the SEC allocates a disproportionate amount of resources to policing the activities of broker-dealers when compared to those we expend policing investment advisers." We agree that the SEC expends significant resources on broker-dealer oversight, in addition to the resources that FINRA devotes to the same activities. We encourage the Commission to consider reallocating its existing resources to increase investment adviser examination activity, which it could accomplish without additional legislation or rulemaking.[7]

We respectfully submit, however, that differences relating to the number of SEC-registered advisory firms and SEC-registered broker-dealer firms do not tell the whole story. For example, we note that the SEC's examination of investment advisory firms covers a significant percentage of total assets under management each year, that OCIE conducts analysis of *all* investment advisers on an ongoing basis, which informs the risk-based determination of which firms to examine, and that the total number of SEC-registered investment advisers is overstated due to the existence of separate legal entities that essentially operate as a single business. We submit that instead of utilizing apples-to-oranges comparisons, it would be more productive to focus on ways to improve the SEC's investment adviser examination program to achieve a higher level of investor protection.

Opportunities to augment the SEC's own investment adviser examination program, including third-party examinations, are also worthy of debate. We are concerned, however, about the potential disadvantages of third-party examinations as compared with SEC examinations. We outlined some of the issues that would need to be addressed in our 2003 comment letter that responded to a similar construct raised by the Commission in connection

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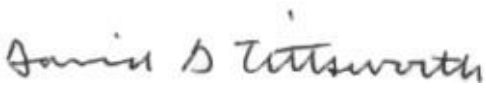
[7] We also encourage OCIE to continue to improve the productivity of its examination program, and offer our assistance to the Commission and OCIE in developing additional efficiencies in the program.

with the proposed compliance program rule.[8] Such issues include the standards to be applied in such examinations, the scope and frequency of any such examinations, the qualification and SEC oversight of third parties, confidentiality, and the cost to advisers.

As an initial matter, the Commission may want to consider assessing the types of voluntary third-party reviews that investment advisory firms currently employ. These include financial audits, internal control reports by third parties, compliance reviews by third parties, mock audits, and internal audits. Before engaging in any rulemaking that would require SEC-registered advisory firms to undertake an examination or other review by a third party, it would be helpful to understand what practices are already undertaken, how such practices are utilized, the types of third parties retained, and the costs involved.

Given our common goal of enhancing the Commission's investment adviser oversight, we believe it would be helpful to discuss these issues with you. I trust that you will not hesitate to contact us if we may provide any additional information and we look forward to discussing the costs and benefits of all appropriate options at your earliest convenience.

Sincerely,



David G. Tittsworth
President & CEO

Cc: Hon. Mary Jo White
Hon. Luis A. Aguilar
Hon. Kara M. Stein
Hon. Michael S. Piwowar

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[8] Letter from David G. Tittsworth, Executive Director, ICAA to Jonathan G. Katz, Secretary, SEC, re: File No. S7-03-03: Proposed Rule: Compliance Programs of Investment Companies and Investment Advisers (Apr. 17, 2003) available at http://www.sec.gov/rules/proposed/s70303/icaa041703.htm.

June 6, 2014

Via Electronic Mail

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, DC 20210

Re: RIN 1210-AB08: 408(b)(2) Guide

Ladies and Gentlemen:

The Investment Adviser Association[1] appreciates the opportunity to comment on the Department of Labor's proposed amendment to its final rule under section 408(b)(2) of the Employee Retirement Income Security Act (ERISA).[2] The Department's proposal would require that the disclosures required of service providers to ERISA retirement plans under the current rule include a guide to the disclosures.

While we do not support a guide requirement in general, our specific comments focus on disclosures by investment advisers registered with the Securities and Exchange Commission (SEC) to responsible plan fiduciaries acting on behalf of plans in entering into individually managed "separate account" arrangements. As we detail below, the fees and services provided under such arrangements are straightforward and generally found in two documents, the investment management agreement and the adviser's Form ADV, Part 2. In light of the sophistication of the plan fiduciaries representing plans in such arrangements and the uncomplicated nature of their fee structures, we believe that the addition of a guide to the disclosures in such a context would not add to the fiduciaries' already detailed understanding of the structures and thus would be unnecessary. If the Department were to conclude that a guide should be required in this context, we suggest a streamlined guide for such arrangements.

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[1] The Investment Adviser Association ("IAA") is a not-for-profit association that represents the interests of investment adviser firms registered with the SEC. Founded in 1937, the IAA's membership consists of more than 500 firms that collectively manage approximately $14 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations. For more information, please visit our website: www.investmentadviser.org.

[2] Amendment Relating to Reasonable Contract or Arrangement Under Section 408(b)(2) – Fee Disclosure, 79 Fed. Reg. 13949 (Mar. 12, 2014).

Background

The IAA has long maintained that the section 408(b)(2) disclosure regime should not apply in the context of the straightforward fee arrangements typical for defined benefit plans. In response to the Department's initial 2007 proposal, the IAA focused its testimony at the 2008 public hearing on the application of the proposed regulation to defined benefit plans. The IAA noted that the Department's disclosure proposal was prompted primarily by concerns about fees and expenses in defined contribution plans and the changes in the fee structures of these plans over time.[3] Such structural changes generally had not occurred in the defined benefit context; therefore, the IAA questioned whether the proposed rule should apply to defined benefit plans.

The IAA's comments on the 2010 interim final rule reiterated these concerns, especially as to the Department's request for comments on the advisability of adding a requirement for a summary or guide to the disclosures. Our 2010 letter expressed concern that the development and implementation of this concept would be difficult, because of the variety of arrangements to which it would apply. The letter suggested that, if such a summary or guide were to be required, then this requirement should not apply in the defined benefit plan context, in light of the straightforward nature of the compensation arrangements and the ability of prospective clients to easily compare among potential providers of investment advisory services.[4]

Current Proposal to Require a Guide to the Disclosures

We continue to believe that a guide is not necessary, especially in situations in which the fee and compensation structure is simple and straightforward, such as in the context of an investment adviser's services to plans through individually managed separate accounts.[5] Such accounts typically involve plans for which sophisticated responsible plan fiduciaries select investment advisers. The compensation received by the investment adviser in almost all circumstances is a percentage of assets under management. This percentage typically decreases as the assets of the account grow, in accordance with established breakpoints.

The responsible plan fiduciary for such a plan generally will issue a request for proposal (RFP) from potential advisers, often with the assistance of a pension consultant. In responding to the RFP, advisers provide detailed information about their experience, services and compensation. When the plan selects an investment adviser through the RFP process, the parties negotiate an agreement. The negotiations address numerous aspects of the relationship, and the form of agreement is often provided by the client, not the adviser. Therefore, clients establishing

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[3] The IAA's 2008 testimony is available at http://www.dol.gov/ebsa/pdf/IAA408b2.pdf.

[4] The IAA's 2010 comment letter is available at http://www.dol.gov/ebsa/pdf/1210-AB08-0029.pdf.

[5] Such accounts are established most often in the defined benefit context.

these accounts are well-versed as to the terms of the agreements, which reflect the client's original agreement and any negotiated changes to that agreement.[6]

Modified Guide Requirement

In the alternative, if the Department were to require a guide, we request that the requirements be tailored to accommodate these accounts and current practices to which plan clients have become accustomed since the final rule under section 408(b)(2) became effective in 2012. First, the number of documents or pages should not be dispositive in determining whether a guide should be required for individually managed separate accounts. Instead, the final rule should provide that investment advisers' required disclosures need not be accompanied by a guide if they are contained in two documents, the investment management agreement and the adviser's Form ADV, Part 2.

Responsible plan fiduciaries negotiate (and in many cases actually draft) the investment management agreement and therefore already know its terms. Typically, the other source of 408(b)(2) disclosures is the investment adviser's Form ADV, which must be provided to clients initially, along with (at least) annual updates in the event of changes. This document is required under the Investment Advisers Act of 1940, and its form is mandated by the SEC. Importantly, the mandated disclosures in Form ADV, Part 2, which is a narrative brochure, must be presented in a prescribed order and must be introduced by a table of contents. Therefore, the responsible plan fiduciaries that enter into individually managed separate accounts on behalf of plans can easily find relevant information in Form ADV, Part 2.

Second, for the same reasons, the requirement of a page or other locator should not apply in this context. As noted above, the plan fiduciaries who negotiate the investment management agreement do not need directions on how to locate the disclosures. In many cases, the client has the superior knowledge of the location of these provisions, especially if the agreement is based on the client's own document. In addition, because Form ADV, Part 2 must contain an internal table of contents, further direction as to location would be superfluous.

Separate Document Requirement

The proposed rule would require that the guide constitute a separate document. For the reasons set forth above, we urge that investment advisers to individually managed separate accounts be permitted to incorporate a streamlined guide into its existing disclosures. To the extent that an investment adviser does prepare a separate document, however, this document should not be precluded from including disclosures in addition to serving as a "roadmap." Some

[6] Indeed, our members report that in order to prepare a customized guide for each client, they may need to sort through hundreds of individualized agreements drafted primarily by the clients to whom they must provide the disclosures.

advisers to separate accounts and other arrangements already use a form of guide that provides required disclosures as well as a "roadmap" to the other documents containing the disclosures. This approach may bring more attention to certain disclosures. Furthermore, these advisers' clients are accustomed to receiving such documents, and have not reported any confusion. Advisers therefore should be permitted to continue providing these types of disclosures.

Annual Update Requirement

The proposed amendment would include a requirement that the guide be updated annually for changes. We submit that updates would be redundant in that the client would have to have agreed to changes in the relevant fees and services before the changes came into effect. To rehash these changes annually would not add to these clients' understanding and could lead to more confusion if the client thought that the annual update reflected a separate round of changes. In addition, under SEC rules, within 120 days of the firm's fiscal year end, the adviser must deliver to each client: (1) an updated Form ADV, Part 2 brochure with a summary of material changes, or (2) a summary of material changes that includes an offer to provide a copy of the updated brochure and information on how the client may obtain the brochure. Thus, the plan client would automatically receive an annual update to the Form ADV, Part 2 if there were changes from the brochure previously provided. If the Department required a separate annually updated guide in this context, then the same date (within 120 days of the firm's fiscal year end) should apply to changes in the 408(b)(2) disclosures in order to simplify the distribution of the updates.

Effective Date

The Department proposes in the preamble that the guide requirement would be effective 12 months after final publication of the final amendment in the Federal Register. Whether that timeframe would be sufficient will depend upon the scope of the final amendment; therefore, we cannot predict the length of time that investment advisers would need to prepare. We also request that the Department clarify that the amendment would apply only to those contracts or agreements entered into, extended or renewed after the effective date.

Regulatory Impact Analysis

The cost estimates in the Department's regulatory impact analysis appear to be based primarily on the number of U.S. registered investment companies; therefore, the analysis does not fully consider the impact of the proposed rule on investment advisers that provide investment

advisory services to retirement plans.[7] We submit that the Department has underestimated the potential scope of the proposed guide, and urge the Department to revise its regulatory impact analysis in order to more precisely reflect the potential costs of this proposal.

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The IAA appreciates the Department's consideration of this letter. We look forward to working with you on these important issues, and request the opportunity to testify at any public hearing on the proposed amendment. If you have questions or require further information, please contact the undersigned at (202) 293-4222.

Sincerely,

Kathy D. Ireland
Associate General Counsel

cc: Joe Canary, Director, Office of Regulations and Interpretations, EBSA
Allison Wielobob, Senior Employee Benefits Law Specialist, Office of Regulations and Interpretations, EBSA

[7] 79 Fed. Reg. 13958. In addition, the analysis states that "[t]here were 776 financial services firms that provided investment management services in the U.S.," but this figure is likely drawn from the 2013 Investment Company Fact Book, which describes this 776 figure as the number of "financial firms from around the world [that] competed in the U.S. market to provide investment management services to fund investors" (emphasis supplied). *Id.*; 2013 Investment Company Fact Book at 13 (available at http://icifactbook.org/pdf/2013_factbook.pdf). Although the Department's cost analysis does not appear to rely on this number, we note that, according to the SEC's records, there were over 10,500 SEC-registered investment advisers on April 12, 2013, of which 49.1% indicated at least one pension or profit sharing plan client. *Evolution Revolution 2013 – A Profile of the Investment Adviser Profession* (available at https://www.investmentadviser.org/eweb/docs/Publications_News/Reports_and_Brochures/IAA-NRS_Evolution_Revolution_Reports/evolution_revolution_2013.pdf).

April 11, 2014

Filed by email to CPOandCTAfeedback@nfa.futures.org

Ms. Mary McHenry
Associate Director, Compliance
National Futures Association
300 South Riverside Plaza, Suite 1800
Chicago, IL 60606-6615

Re: CPO/CTA Capital Requirements and Customer Protection Measures

Dear Ms. McHenry:

The Investment Adviser Association ("IAA")[1] is submitting this letter to the National Futures Association ("NFA") on behalf of investment advisers that are registered with the Securities and Exchange Commission ("SEC") under the Investment Advisers Act of 1940 (the "Advisers Act"). Many of our members are also registered under the Commodity Exchange Act ("CEA") as a commodity trading advisor ("CTA") and/or a commodity pool operator ("CPO"). We appreciate the opportunity to comment on the NFA's consideration of whether to impose capital requirements and other customer protection measures as set forth in NFA's Notice to Members I-14-03 issued on January 23, 2014 and Notice to Members I-14-05 issued on January 30, 2014 (collectively, the "Notices to Members").

We commend the NFA for reviewing the effectiveness of its existing rules in light of recent cases and the prevention of misuse of customer funds. We share the NFA's desire to ensure protection of customer assets. We respectfully submit, however, that the measures with respect to which the NFA requests comment are not likely to be particularly effective in addressing the NFA's concerns and are not necessary in light of strong protections already in place that apply to SEC-registered investment advisers. Indeed, the current regulatory framework under the Advisers Act addresses the issues identified by the NFA in the Notices to Members with respect to CPOs and CTAs that are also registered investment advisers. The NFA also should assess all of the new information that is available to it pursuant to recent regulatory changes before proposing additional requirements.

[1] The Investment Adviser Association is a not-for-profit association that represents the interests of investment adviser firms registered with the Securities and Exchange Commission. Founded in 1937, the IAA's membership consists of more than 550 advisers that collectively manage approximately $14 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations. For more information, please visit our web site: www.investmentadviser.org.

Further, the substantial costs that would be imposed pursuant to the proposed measures – which may be passed on to pool participants and other clients – appear to be disproportionate to any regulatory benefit gained. We look forward to working with the NFA as it considers these issues.

I. The Regulatory Regime for SEC-Registered Investment Advisers Provides Strong Protections of Client Assets

In examining measures to strengthen the regulation of CPOs and CTAs to enhance customer protection, we believe that the NFA should consider the strong protections currently in place with respect to SEC-registered investment advisers.[2] Below, we discuss key elements of the regulatory framework to which registered advisers are subject, which we believe provides appropriate protection of customer assets.

Fiduciary Duties and Advisers Act Overview

Investment advisers provide professional advice to their clients regarding investments in stocks, bonds, and other securities, as well as derivatives. In so doing, investment advisers are subject to a comprehensive regulatory regime under the Advisers Act, including a framework of numerous specific rules and interpretive guidance developed by the SEC, most of which are derived from the longstanding overarching fiduciary duty advisers owe to their clients. As fiduciaries, investment advisers have a duty to act in the best interests of their clients and are subject to duties of both loyalty and care, including an obligation not to subordinate clients' interests to their own.[3] A critical element of an adviser's fiduciary duty is the duty to provide full and fair disclosure of all information that a client would find important in selecting and retaining an adviser. If an investment adviser does not act in the best interest of a client, it may

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[2] Indeed, of the 26 Member Responsibility Actions ("MRAs") issued by NFA since January 1, 2011, only one involved an investment adviser registered with the SEC. *Notice of Member Responsibility Action Under NFA Compliance Rule 3-15*, NFA Case No. 13-MRA-007 (Oct. 21, 2013). Other MRAs involved firms that lacked the proper registrations with regulatory authorities. *Notice of Member and Associate Responsibility Action Under NFA Compliance Rule 3-15*, NFA Case No. 13-MRA-001 (Jan. 31, 2013) (the NFA stated that, although the firm represented that it traded security futures products and traded forex, the firm was not registered as a broker-dealer and was not designated as a forex firm); *Notice of Member Responsibility Action and Associate Responsibility Action Under NFA Compliance Rule 3-15*, NFA Case No. 13-MRA-004 (May 22, 2013) (the NFA noted that an associated person, Klaus Weyers, admitted that he had been operating a firm as a commodity pool, but had not registered the pool or filed an exemption from registration); and *Notice of Member Responsibility Action and Associate Responsibility Action Under NFA Compliance Rule 3-15*, NFA Case No. 12-MRA-002 (Jan. 27, 2012) (the affidavit states that the firm had been engaging in retail forex but had not been approved as a forex firm).

[3] In *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963), the Supreme Court held that Section 206 of the Advisers Act imposes a fiduciary duty as a matter of law, which includes both a duty of loyalty and a duty of care. For example, an adviser "should not engage in any activity in conflict with the interest of any client, and [an adviser] should take steps reasonably necessary to fulfill [its] obligations. [An adviser] must employ reasonable care to avoid misleading clients and [advisers] must provide full and fair disclosure of all material facts to [the adviser's] clients and prospective clients." *Information for Newly-Registered Investment Advisers*, SEC (Nov. 23, 2010).

be liable for breaching its fiduciary duty, regardless of whether a client suffers a monetary loss.[4] Moreover, as fiduciaries, investment advisers must treat their clients fairly and not favor themselves or favor one client over another, especially if the adviser would somehow benefit. In addition, whenever the interests of an adviser differ from those of its clients, the adviser must explain the conflict to the client, and act to mitigate or eliminate the conflict. The nature and extent of an investment adviser's fiduciary obligations under the Advisers Act do not depend on whether an instrument is a security, a futures contract, or a swap; this is because the Advisers Act regulates the relationship between the adviser and each of its clients rather than the particular transaction or instrument.[5]

The fiduciary duty is overarching – an overlay on the specific rules and regulations to which advisers are subject. However, advisers are also subject to numerous specific regulations, including on-point rules that address the potential concerns with respect to which the NFA has requested comment. For example, investment advisers are subject to anti-fraud provisions under the federal securities laws, rules governing advertisements, marketing materials and other communications with investors, rules regarding the adoption and maintenance of compliance policies and procedures (and an annual review of the effectiveness of such policies and procedures), codes of ethics (governing personal trading) and the supervision of employees, privacy regulations relating to client information, and recordkeeping and reporting rules (such as Form PF). Investment advisers are also subject to on-site examinations by SEC staff — in these examinations, the staff, among other items, reviews an investment adviser's compliance program and records to determine whether the investment adviser is operating in compliance with applicable regulatory requirements.

Compliance Program

Investment advisers must maintain a compliance program that addresses the adviser's performance of its fiduciary and substantive obligations under the Advisers Act. Rule 206(4)-7 under the Advisers Act requires each investment adviser to adopt and implement written compliance policies and procedures that are reasonably designed to prevent the adviser and its personnel from violating the Advisers Act and the rules thereunder, and the adviser must review the effectiveness of the policies and procedures at least annually. The adviser must also designate a chief compliance officer with responsibility to oversee the implementation of the compliance program.[6]

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[4] *See Regulation of Investment Advisers by the U.S. Securities and Exchange Commission*, SEC (Mar. 2013).

[5] Investment advisers that provide investment management services to plans that are covered by the Employee Retirement Income Security Act of 1974 ("ERISA") on a discretionary basis also are fiduciaries under ERISA, and must satisfy fiduciary responsibilities both under the Advisers Act and under ERISA with respect to the assets they manage for such plans.

[6] The Commodity Futures Trading Commission ("CFTC") has recently amended Regulation 3.1(a) to include a chief compliance officer as a principal of a registrant. *Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules;*

The SEC expects a compliance program to address, among other items, the safeguarding of client assets from conversion or inappropriate use by advisory personnel, as well as by promptly detecting misuse and by taking appropriate action upon misuse.[7] The SEC has provided guidance regarding the types of policies and procedures related to protection of client assets that advisers should consider, including:

> [c]onducting background and credit checks on employees of the investment adviser who will have access (or could acquire access) to client assets to determine whether it would be appropriate for those employees to have such access; [r]equiring the authorization of more than one employee before the movement of assets within, and withdrawals or transfers from, a client's account, as well as before changes to account ownership information; [l]imiting the number of employees who are permitted to interact with custodians with respect to client assets and rotating them on a periodic basis; and [i]f the adviser also serves as a qualified custodian for client assets, segregating the duties of its advisory personnel from those of custodial personnel to make it difficult for any one person to misuse client assets without being detected.[8]

In addition to policies related to safeguarding assets, a compliance program should address, as applicable:

> …[p]ortfolio management processes, including allocation of investment opportunities among clients and consistency of portfolios with clients' investment objectives, disclosures by the adviser, and applicable regulatory restrictions; [t]rading practices, including procedures by which the adviser satisfies its best execution obligation, uses client brokerage to obtain research and other services ("soft dollar arrangements"), and allocates aggregated trades among clients; [p]roprietary trading of the adviser and personal trading activities of [employees and officers]; [t]he accuracy of disclosures made to investors, clients, and regulators, including account statements and advertisements; … [t]he accurate creation of required records and their maintenance in a manner that secures them from unauthorized alteration or use and protects them from untimely destruction; [m]arketing advisory services, including the use of solicitors; [p]rocesses to value client holdings and assess fees based on those valuations; [s]afeguards for the

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and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants, 77 Fed. Reg. 20128, 20156 (Apr. 3, 2012).

[7] *See Compliance Programs of Investment Companies and Investment Advisers*, SEC Release No. IA-2204, 68 Fed. Reg. 74714 (Dec. 24, 2003) ("Compliance Release").

[8] *Custody of Funds or Securities of Clients by Investment Advisers*, Final Rule, Release No. IA-2968, 75 Fed. Reg. 1456, 1467 (Jan. 11, 2010) ("2009 Custody Rule Amendments").

> privacy protection of clients records and information; and [b]usiness continuity plans.[9]

Advisers are expected to monitor and conduct testing of the effectiveness of their compliance programs. In addition, advisers must adopt written codes of ethics, which must set forth standards of conduct expected of advisory personnel to reflect the advisers' fiduciary obligations and to address conflicts that arise from personal trading by advisory personnel. To comply with these rules, investment advisers must demonstrate a robust control environment.

Custody Rule

Adviser regulations layer numerous special protections to address risks posed by access to client assets. Investment advisers are required to comply with Advisers Act Rule 206(4)-2 (the "Custody Rule"), which deems an adviser to have custody of client assets when it holds "directly or indirectly, client funds or securities or [has] any authority to obtain possession of them."[10] In addition, an adviser is deemed to have custody of assets where it or a related person acts in any capacity that gives it legal ownership of, or access to, client funds or securities, such as the general partner of a limited partnership or the managing member of a limited liability company, or if a related person directly or indirectly holds the client assets.[11] A "related person" is defined as a person directly or indirectly controlling or controlled by the adviser and any person under common control with the adviser.[12]

Advisers are subject to restrictions on holding client assets, which are designed to provide special protections. An investment adviser with custody of client assets is required to maintain those assets with a qualified custodian – that is, a bank, broker-dealer, or futures commission merchant ("FCM") – in a separate account for each client under that client's name or in accounts that contain only clients' funds or securities, under the investment adviser's name as agent or trustee for the clients.[13] An adviser deemed to have custody of client assets is also required to have a reasonable basis after "due inquiry" for believing that the qualified custodian sends each of its clients (or the client's independent representative) account statements identifying the amount of funds and the amount of each security in the account at the end of the period and

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[9] Compliance Release, 68 Fed. Reg. at 74716.

[10] Advisers Act Rule 206(4)-2(d)(2).

[11] *Id.* Previously, investment advisers were determined not to have custody if the general partner of a pooled investment vehicle (or similar official) entered into a contract with an independent representative and the vehicle's custodian. *Bennett Management Company*, SEC No-Action Letter (Feb. 26, 1990); and *PIMS Inc.*, SEC No-Action Letter (Oct. 21, 1991). This requirement was rescinded in 2003 with the adoption of the new Custody Rule. *Custody of Funds or Securities of Clients by Investment Advisers,* SEC Release No. IA-2176, 68 Fed. Reg. 56692, fn 11 and 15 (Oct. 1, 2003).

[12] Advisers Act Rule 206(4)-2(d)(7).

[13] Advisers Act Rule 206(4)-2(a).

setting forth all transactions in the account during that period, on at least a quarterly basis. Such advisers must also undergo an annual surprise examination by an independent public accountant to verify client assets, unless an exception applies.[14] Advisers must also disclose to clients the importance of comparing advisory account statements with statements from the client's custodian.

If an investment adviser or a related person maintains client assets as a qualified custodian, the accountant conducting the surprise examination must be registered with, and subject to inspection by, the Public Company Accounting Oversight Board ("PCAOB").[15] The accountant must file a certificate on Form ADV-E with the SEC within 120 days of the time chosen by the accountant for the exam, stating that it has examined the funds and securities and describing the nature and extent of the examination. Upon the finding of any material discrepancy during the course of the examination, the accountant is required to notify the SEC within one business day.[16] Further, if the accountant is terminated for any reason, it must notify the SEC within four business days. Investment advisers to pooled investment vehicles are not required to have a surprise audit or have the custodian send account statements if an accounting firm that is PCAOB-registered and inspected audits the pool and delivers the audited financials to investors annually.

In addition, investment advisers are required to obtain an annual report of the custodian's internal controls relating to the custody of those assets from a PCAOB-registered independent public accountant, unless client assets are maintained with an independent custodian.[17] Among other items in the internal control report, the accountant must opine on whether the custodian's internal controls are suitably designed and are operating effectively.[18] The accountant also must verify that client assets are reconciled to a custodian other than the adviser or its related person.[19]

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[14] The SEC has provided guidance that, during the surprise examination, an accountant should obtain from the investment adviser records that detail client funds and securities of which the adviser has custody and the identity of the qualified custodians. *Commission Guidance Regarding Independent Public Accountant Engagements Performed Pursuant to Rule 206(4)-2 Under the Investment Advisers Act of 1940*, SEC Release No. IA-2969, 75 Fed. Reg. 1492, 1493 (Jan. 11, 2010) ("SEC Audit Guidance").

[15] The SEC has determined that registration with, and oversight by, the PCAOB is an important check on the quality of the accountants. 2009 Custody Rule Amendments, 75 Fed. Reg. at 1460.

[16] SEC Audit Guidance, 75 Fed. Reg. at 1493.

[17] SEC Rule 206(4)-2(a)(6). The internal control report's objective is "to obtain reasonable assurance that the qualified custodian's controls have been placed in operation as of a specific date, and are suitably designed and are operating effectively to meet control objectives related to custody of funds and securities during the period specified." SEC Audit Guidance, 75 Fed. Reg. at 1493.

[18] 2009 Custody Rule Amendments, 75 Fed. Reg. at 1463 and 1484.

[19] 2009 Custody Rule Amendments, 75 Fed. Reg. at 1463.

Form ADV

Investment advisers are required to register and provide disclosures on Form ADV, and update the form annually and more frequently upon changes to certain disclosures. The Form ADV contains detailed information about an investment adviser's operations, including its financial condition and disciplinary history. Part 1 and Part 2A of Form ADV are publicly available online on the Investment Adviser Public Disclosure website.[20] Part 1A of Form ADV, among other items, requires the investment adviser to identify each custodian used for private funds. Item 7 of Part 1A requires an adviser to report all related persons who are broker-dealers and to identify those that serve as qualified custodians with respect to client assets. Item 9 of Part 1A requires an adviser with custody, including one deemed to have custody through its related persons, to report the amount of client assets and the number of clients for whom the adviser has custody, unless the adviser has custody solely due to fee deduction. Advisers must also disclose whether they have had a surprise examination or an annual audit, or have obtained an internal control report. Changes as to whether an adviser or any of its related persons have custody of client assets must be updated promptly on the IARD website.

Pursuant to Item 11 of Part 1A, an adviser is required to make disclosures about its disciplinary history, and any changes to this information must be updated promptly on the IARD website. Schedule D includes additional items that require an adviser to identify the accountants that perform its or its funds' audits, surprise examinations and internal control reports, as well as list any related persons that serve as qualified custodians. Item 9 of Part 2A also requires disclosure of disciplinary information about the adviser and its management persons including, among other items, whether the adviser and its management persons have been convicted of, or are the subject of a criminal proceeding involving, fraud, bribery, perjury, forgery or extortion. An adviser is required to promptly inform its clients and update its disclosures on the IARD website upon the occurrence of any changes to disciplinary disclosures. In addition, Item 18 of Part 2A requires an adviser to make disclosures regarding its financial condition under certain circumstances.[21] If any of the disclosures in Item 18 become materially inaccurate, the adviser is required to update promptly the disclosures on the IARD website. These Form ADV disclosures provide both clients and the SEC with critical information that enables appropriate and ongoing oversight of advisory activities.

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[20] Note that while an adviser files its Form ADV on the Investment Adviser Registration Depository ("IARD") website, the information is publicly accessible on the Investment Adviser Public Database, available at: http://www.adviserinfo.sec.gov/IAPD/Content/Search/iapd_Search.aspx.

[21] Item 18 of Form ADV Part 2A requires that an adviser: (i) provide a balance sheet of the adviser's most recent fiscal year if the adviser requires payment of at least $1,200 in fees from a client at least 6 months in advance; (ii) disclose any financial condition that is reasonably likely to impair the adviser's ability to meet contractual commitments to clients if the adviser has discretionary authority or custody of client assets or requires payment of at least $1,200 in fees from a client at least 6 months in advance; and (iii) if the adviser was the subject of a bankruptcy petition in the prior 10 years, disclose the current status of such petition.

We believe that, taken as a whole, these various requirements provide strong protections against risks of the kind that the NFA seeks to address in its release. Advisers are required to, and do, expend significant efforts on designing and maintaining appropriate compliance programs, including in the area of client asset protection – a requirement that is reinforced and monitored through SEC (and NFA) staff examinations and enforcement and public and private disclosure of information through regulatory reporting on various disclosure forms, as discussed further below. Accordingly, when considering a capital requirement and other customer protection measures, we urge the NFA to recognize the extent to which clients of SEC-registered investment advisers are already covered by fiduciary standards, the compliance program requirements, special protections under the Custody Rule, and disclosures on Form ADV.

II. New Regulatory Requirements Provide Additional Protections

In addition to the existing robust Advisers Act regulatory framework, advisers are subject to new reporting requirements. These new reporting requirements include SEC Form PF and CFTC Forms CPO-PQR and CTA-PR, as well as enhanced reporting requirements under NFA rules.[22] These new reports will provide the NFA and other regulators with direct and unprecedented access to information regarding the operations and finances of CPOs and CTAs.[23] The NFA and CFTC have also adopted enhancements to the procedures for safeguarding funds related to commodity interest trading by all customers.[24] Before creating new regulatory

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[22] CFTC Regulation 4.27 and NFA Compliance Rule 2-46.

[23] As noted on page 1 of the *Annual Staff Report Relating to the Use of Data Collected from Private Fund Systemic Risk Reports* (Staff of the Division of Investment Management, SEC, Jul. 25, 2013):

> [SEC] staff has begun to assess the quality of the data collected — including evaluating the consistency of filer responses and differences in approaches or assumptions made by filers — and has used the data on occasion to obtain information regarding a specific or small number of private funds. In addition, a number of uses of the information have already been identified across various [SEC] Divisions and Offices. In particular, the Division of Economic and Risk Analysis has successfully incorporated Form PF data into its proprietary analytical tool; the Division of Investment Management's Risk and Examinations Office is working to develop analytics using Form PF information that will allow it to monitor the risk-taking activities of investment advisers to private funds; and the Office of Compliance Inspections and Examinations anticipates using the information collected on Form PF in conducting pre-examination due diligence and in risk identification.

We also understand that NFA staff is using data in Forms CPO-PQR, CTA-PR, NFA-PQR, and NFA-PR in determining which registrants to examine.

[24] *Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations*, CFTC, 78 Fed. Reg. 68506 (Nov. 14, 2013); *New Notification and Report Filing Requirements Required under CFTC Final Rule on Enhancing Customer Protections Afforded Customers and Customer Funds Held by FCMs and DCOs*, NFA Notice to Members I-13-46 (Dec. 31, 2013); *Amendments to NFA Financial Requirements Section 4, Use of Technology to Monitor FCM Segregation Compliance* (effective Feb. 15, 2013); and *Amendment to NFA Financial Requirements Section 4 and Adoption of NFA Financial Requirements Section 16 and its Related Interpretive Notice Regarding FCM Financial Practices and Excess Segregated Funds/Secured Amount Disbursements* (effective Sept. 1, 2012). The NFA has also adopted and

requirements, these current requirements should be fully implemented and evaluated. At that point, the NFA can more appropriately assess whether there is a gap in data or protections that should be addressed in a targeted fashion by additional regulation.

We discuss below the specific measures raised by the Notices to Members.

III. CPO/CTA Capital Requirements

A. Capital Requirements for Advisers Would Not Add to Customer Protection and Are Not Necessary for Investment Advisers

1. The Characteristics of Investment Advisers' Business and Operations Make Capital Requirements Unsuitable

Basic features of investment advisers and their business and regulatory structures contradict the suggestion that capital requirements might be an appropriate customer protection tool with respect to investment advisers. These features include the absolute separation between an investment adviser's assets and liabilities and the assets and liabilities of the pool or account it manages, the absence of any legal obligation for an investment adviser to back-stop investor losses or guarantee investment performance, and the impact of existing regulations that prohibit investment advisers from commingling client assets with proprietary assets in the investment adviser's name or using the assets of one client to meet the obligations of another client of the investment adviser. In addition, advisers, unlike other types of financial firms such as banks and certain types of broker–dealers, generally do not act as principals in their dealings with clients; instead, advisers function only as fiduciary agents, without balance sheet exposure by or to clients. Because fund investment vehicles (such as limited partnerships, limited liability companies, and offshore companies) offer investors limited liability, the investment adviser's creditors do not have recourse to investor assets. Similarly, creditors of an adviser do not have recourse to separate account assets. Thus, investor assets are typically not at risk if an adviser encounters financial difficulties and therefore capital requirements would not provide greater protection for customer funds.

In light of the unique characteristics of investment advisers, Congress, the SEC and the CFTC have not imposed capital requirements on investment advisers, CPOs, or CTAs. In the almost 40-year history of CPO/CTA regulation under the CEA,[25] Congress has reconsidered the

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submitted for CFTC approval amendments to the NFA's financial requirements, which would provide online access to FCM customer segregated/secured amount bank account information. *Amendments to NFA Financial Requirements Section 4 To Provide On-Line View-Only Access to FCM Customer Segregated/Secured Amount Bank Account Information* (Aug. 21, 2012).

[25] The CFTC has never formally proposed minimum capital requirements for CPOs or CTAs. When the CFTC first proposed regulations of CPOs and CTAs, it requested comment upon whether there should be a minimum net worth requirement for CPOs, which had been recommended by the CFTC's Advisory Committee on Commodity Futures Trading Professionals. *Commodity Pool Operators: Proposed Comprehensive Scheme for Regulation*, 42 Fed. Reg.

CEA as part of the process of reauthorizing the CFTC roughly every four or five years (the latest cycle is currently underway) and has never seriously considered authorizing the CFTC to adopt minimum capital requirements as a prerequisite for registration as a CPO or CTA.[26] We believe that it would be an anomalous result for the NFA to impose capital requirements on CPOs and CTAs (and therefore on investment advisers) considering that none of Congress, the SEC or the CFTC have done so.[27]

While capital requirements may be appropriate for a bank or a broker-dealer, they are not appropriate for an investment adviser. Banks and broker-dealers, which often act as principals, not agents, in their dealings with customers, are subject to significantly different business risks than a registered investment adviser. Capital requirements for banks protect against depositors losing the value of their deposits and incentivize banks to operate prudently. Capital requirements for broker-dealers help to manage the orderly liquidation of a broker-dealer and the transfer of customer assets to another broker-dealer. In contrast, investment advisers do not accept deposits, hold client assets, or clear or settle trades. Therefore, capital requirements for investment advisers, which are subject to fiduciary duties and generally act only in the capacity of agent on behalf of their clients, would not protect against investment losses experienced by clients. Clients already easily and frequently move their assets between investment advisers.

Further, while introducing brokers are subject to capital requirements, introducing brokers and investment advisers are not analogous businesses given the differences in their operations and their industries. Introducing brokers are typically small operations that satisfy their net capital requirements through guarantee arrangements with FCMs. Introducing brokers enter into guarantee arrangements because of the expense associated with complying with net capital requirements. After an introducing broker enters into a guarantee arrangement with an FCM, it is restricted to introducing accounts only to its guarantor FCM. Investment advisers are

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9266 (Feb. 15, 1977). After reviewing the comments on that concept, which were generally opposed, the CFTC decided not to adopt financial standards for CPOs. *Commodity Pool Operators and Commodity Trading Advisors; Final Rules*, 44 Fed. Reg. 1918 (Jan. 8, 1979). The CFTC never raised the issue of minimum capital requirements for CTAs, against which the Advisory Committee had recommended.

[26] The requirements pertaining to the registration of CPOs and CTAs are set forth in CEA Section 4n (7 U.S.C. §6n), which was added to the CEA when the CFTC was created in 1974. The Commodity Futures Trading Commission Act of 1974, Pub. L. 93-463, 88 Stat. 1389 (Oct. 23, 1974), §205. That provision has not been substantively amended since, and the last time there was even a conforming amendment, it was a part of the Futures Trading Act of 1982. That Act represented a major overhaul of the CEA, including the creation of the introducing broker registration category and the mandate that registrants in that category must meet minimum financial requirements, yet no such requirements were authorized for CPOs or CTAs. *Futures Trading Act of 1982*, Pub. L. 97-444, 96 Stat. 2294 (Jan. 11, 1983), §§ 208, 213.

[27] The CFTC and the NFA have had a long history of dealing with dually registered firms that are both securities broker-dealers ("BDs") regulated by the SEC and futures commission merchants ("FCMs") regulated by the CFTC. Such firms have long been subject to minimum capital requirements because they handle customer funds, and the CFTC and SEC have endeavored over the years to harmonize the minimum capital requirements for BDs and FCMs to the extent practicable to avoid duplicative or conflicting requirements.

typically larger operations than introducing brokers, and use multiple FCMs. Given the typical firm size and type of activities engaged in by advisers, FCMs are unlikely to be willing to enter into guarantee arrangements with advisers. Further, investment advisers and introducing brokers are subject to different regulatory requirements. Congress mandated net capital requirements for introducing brokers, but has not enacted these requirements for investment advisers. Investment advisers are already subject to extensive regulatory requirements, as discussed in this letter, which address the CFTC's net capital concerns. Introducing brokers are not subject to these requirements, even if they have discretionary authority over a limited percentage of accounts, but are instead subject to capital requirements.

2. Investment Advisers are Subject to Regulatory Requirements that Provide for Client Protection

The NFA also posits that capital requirements would ensure that CPOs and CTAs "have sufficient assets to operate as a going concern." As noted above, the failure of an adviser should not put its clients' assets at risk, as the clients' funds are required to be maintained separately from the assets of the adviser. In addition, investment advisers are required to make disclosures regarding their financial condition annually on their Form ADVs, thus providing clients with a "warning bell" in advance of an adviser failure.[28] Item 18 of Form ADV requires an adviser to disclose any financial condition that would be reasonably likely to impair its ability to meet contractual commitments to provide services to clients. This item also requires any adviser to disclose if it has been subject to a bankruptcy petition in the prior 10 years and provide the current status of the bankruptcy petition. Further, as discussed above, an adviser has a duty to self-report material financial difficulties during the year in its Form ADV Part 2A, which is available on the IARD website. In determining which firms must respond to Item 18, the SEC has made a policy judgment that there are three situations where the "going concern" viability of an adviser is material: (i) when the adviser collects client fees over $1,200 in advance; (ii) when the adviser has discretionary authority over client assets; or (iii) if an adviser has custody of client assets. For these situations, the SEC has determined that disclosure is the appropriate regulatory tool. A CPO or a CTA does not present materially different "going concern" issues than an adviser to separate accounts, private funds or investment companies ("RICs") registered under the Investment Company Act of 1940 (the "Investment Company Act"); accordingly, we recommend that the NFA should carefully consider the SEC's policy judgment that the appropriate regulatory response is disclosure.

Investment advisers are currently subject to many other regulatory requirements that also provide for client protection, thus obviating the necessity for capital requirements. CPOs, investment advisers, and RICs generally cannot have actual custody of client assets, and CPOs and CTAs are generally prohibited from holding client assets in their own name. Rather, client assets must generally be held by a broker, a bank, or an FCM. Further, CPOs are prohibited

[28] See Item 18(B) of Form ADV, Part 2A.

from commingling the property of any of their pools with the property of any other person, and an investment adviser is prohibited from commingling proprietary funds and customer funds.

In addition to regulatory requirements, insurance coverage provides additional protection to clients. Most investment advisers have both Errors & Omissions ("E&O") insurance, which provides coverage in the event that a client holds an adviser responsible for a service that the adviser provided, or failed to provide, and Directors and Officers ("D&O") insurance, which covers indemnification expenses associated with legal actions brought for alleged wrongful acts of the directors and officers of an adviser. Also, many advisers have bonds that are designed to protect investors covered by ERISA, such as corporate pension and retirement plans, from fraudulent or dishonest acts of the fiduciary (*i.e.*, the adviser) who handles the plan assets. Advisers to RICs are required to have fidelity bonds, which bond assets against larceny and embezzlement.[29] The purpose of a fidelity bond or an ERISA bond is to maintain the integrity of a RIC or a pension plan, respectively, and protect the assets of the RIC or pension plan against losses caused by persons at an adviser with access to those assets.

Finally, it is important to note that capital requirements would not appear to address the concerns raised by the NFA in any meaningful way. Imposing capital requirements would not prevent theft of investor assets, nor prevent "bad actors" from simply violating the capital requirements, in addition to other applicable laws. Capital requirements also run the risk that they could cause patently dishonest firms to misappropriate client assets to meet capital requirements or simply to provide false records to the NFA. For example, one of the MRAs involved an introducing broker that falsified its records in an attempt to assure the NFA that it was meeting capital requirements.[30] At the same time, for NFA-regulated firms in general, and in particular the subset of such firms that are already well-regulated as registered investment advisers, the rules would impose increased costs, with no clear corresponding benefit.

B. Capital Requirements Would Have Adverse Business Implications for Investment Advisers

Creating a new regulatory structure for the maintenance of capital by CPOs and CTAs would be an extensive undertaking. Implementation of the net capital rule has been a challenging and costly endeavor by both the regulators and regulated firms (broker-dealers, FCMs and introducing brokers). Such regulations are complicated and encompass many variables, such as, among others, the amount of capital that would be required, the types of assets that would satisfy the capital requirements, whether certain assets would be valued at market value or would be subject to haircuts, where the capital would be held, and the type and frequency of required reports. Capital requirements would also necessitate harmonization with

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[29] Section 17(g) of the Investment Company Act and Rule 17g-1 thereunder.

[30] *Notice of Member Responsibility Action Under NFA Compliance Rule 3-15*, NFA Case No. 11-MRA-005 (Aug. 18, 2011).

other regulations to which advisers are subject. Compliance costs would likely be significant, and some of these additional costs may be passed on to pool investors and other clients. Costs associated with capital requirements on CPOs and CTAs could be a barrier to entry to new firms, which could marginally decrease competition among advisers and have particular impact on smaller firms, to the possible detriment of clients. Given the expense and potential impact on pool investors and other clients, these requirements should only be imposed to address a problem for which there is no alternative solution.

In addition, there could be tax implications for the owners of investment advisers, CPOs and CTAs that are taxed as partnerships, because holding cash or other assets to satisfy capital requirements (in lieu of making distributions to the owners) may create phantom income issues (in which owners are taxed on nominal income which they have not received in cash). When a firm is taxed as a partnership, the owners may be taxed on all income that the partnership earns each year, even if that income is not distributed to the owners because the entity must maintain assets to satisfy capital requirements. This could be particularly disadvantageous to NFA member firms that are stand-alone entities and are not part of a large financial services firm.

IV. Other Customer Protection Measures

The current SEC regulatory regime for investment advisers fully addresses the NFA's concern regarding improper use of pool funds by CPOs. As discussed in Part I of this letter, investment advisers are required to adopt a compliance program and, if they have custody of client assets, are subject to the Custody Rule. In addition, because of institutional investor demand, many private funds provide their investors with financial statements audited in accordance with generally accepted accounting principles ("GAAP") by a reputable accounting firm and use third-party administrators.

We support the NFA's review of its regulatory requirements in light of recent MRAs. However, the MRAs involved behavior that was very egregious and most involved outright fraud by small firms. Given the blatant disregard for applicable regulatory requirements exhibited by the individuals and firms subject to the MRAs, the proposed customer protection measures would likely not have prevented the bad behavior that caused the NFA to bring the MRAs. As a result, the measures under consideration are not likely to be particularly effective in addressing the NFA's concerns regarding the protection of customer funds and would instead impose significant costs on investment advisers and RICs, which may be passed on to pool investors.[31]

[31] We note that some of our members serve as CPOs and CTAs to registered funds. We therefore support the letter submitted by the Investment Company Institute. See Letter from Dorothy M. Donohue, Acting General Counsel, Investment Company Institute, to Ms. Mary McHenry, Associate Director, Compliance, National Futures Association, dated April 11, 2014.

Independent Third-Party Authorization for Disbursement of Pool Funds

The Custody Rule and market practice of investment advisers should address the NFA's concerns behind the recommendation that an independent third party review and authorize a CPO's disbursement of any pool funds. As discussed, pursuant to the Custody Rule, if an investment adviser has custody of client assets, it must either be subject to a surprise examination by an independent public accountant or provide an annual audit consistent with GAAP from a PCAOB-registered and inspected firm to investors. These audited fund financial statements must then be distributed to fund investors. Such an accounting firm serves as an independent third party to verify client assets and to protect against their misappropriation. As part of the audit/surprise examination process, the accounting firm verifies client assets and makes sure that expenses and other payments are supported.[32] As in previous years, the safety of assets and custody was listed as one of the core examination priorities that the SEC staff will focus on in 2014. In addition, the SEC conducts examinations of custodians and transfer agents, which provide additional safeguards of client funds and securities. To verify assets, SEC guidance states that accountants should obtain records that detail the client assets and identify the qualified custodians. The SEC also has provided guidance that the accountants should perform a comprehensive review on sample client accounts, which includes reviewing the "purchases, sales, contributions, withdrawals and any other debits or credits" to such accounts, and confirm the records with the custodian, since the time of the prior examination.[33] After conducting the surprise examination, the independent public accountant must file a certificate on Form ADV-E with the SEC stating that it has examined the funds and securities and describing the nature and extent of the examination.

Further, all CPOs must provide investors with audited financial statements.[34] In addition to the verification requirements set forth in the Custody Rule, all advisers with custody within the meaning of the Custody Rule must also use qualified custodians to hold pool assets and many advisers also use administrators and transfer agents for their pooled vehicles. Accordingly, third parties are already involved in the disbursement process.

In addition, the insertion of third parties into the process may present new concerns. For example, third parties, which likely are not subject to fiduciary duties and may not be bound by SEC regulations or NFA oversight, may lack the expertise to adequately judge the reasonableness of disbursements of pool funds. Also, third parties may be reluctant to take responsibility for approving the disbursement decisions of a CPO, and would likely demand indemnification protections, diligence, and certifications from the CPO, as well as charge fees

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[32] SEC Audit Guidance, 75 Fed. Reg. at 1493.

[33] *Id.*

[34] CFTC Regulation 4.22 and 4.7(b). While Regulation 4.7(b) exempts a CPO from the requirements in Regulation 4.22(c), the CPO would still need to provide investors with audited financial statements pursuant to Regulation 4.22(d).

commensurate with the risk. Moreover, clients may be uncomfortable with a third party's involvement without conducting its own diligence.

Given the need for advisers to act quickly (for example, to satisfy margin calls) and the frequency of disbursements, additional requirements for third-party review and approval could lead to delays, defaults, and inefficiencies in the settlement and margining processes. These requirements would also likely increase operating costs significantly, which would ultimately be borne by pool participants and would likely have a disproportionate and significant impact on retail investors. Third-party authorization might be particularly difficult for CPOs of mutual funds, which offer daily net asset value ("NAV") and process subscriptions and redemptions on an ongoing basis.

Verification of Net Asset Value and Account Statements

The NFA requests comment on whether a third party should prepare or verify account statements, including statements concerning the value of the pool. As discussed above, current regulation and market practice are already in place to ensure that the NAV calculations and account statements of investment advisers are in effect subject to third party verification. For example, advisers to RICs send investors annual audited financial statements. Further, as noted above, registered CPOs are required to send audited financial statements to pool participants under CFTC Regulations 4.7(b) and 4.22(c). In addition, SEC advisers with custody of client assets are required under the Custody Rule either to have a surprise examination (and have the custodian send the client directly quarterly account statements) or deliver audited financial statements to fund participants. In connection with these audits and surprise examinations, the audit firm reconciles client assets and, as part of the audit process, the audit firm reviews the valuation of assets. Because of investor demand, many investment advisers already use independent administrators to calculate the NAV of their private funds (or at least reaffirm the calculation) and reconcile custodial statements. Advisers also often rely on independent pricing services. Further, ISDA counterparties also may be involved in valuing assets. Thus, there is substantial third party involvement in account statements prepared for clients.

Performance Results

Additional requirements to verify performance results are not necessary for investment advisers. If a fund is audited under GAAP, then there already is a process in place to verify the fund's year-end performance results as the auditing firm reviews a fund's NAV. Further, the NFA now has other sources of data to determine if performance is aberrational, *e.g.*, Form PF, Form CPO-PQR and Form NFA-PQR.

SEC-registered investment advisers are subject to detailed disclosure requirements regarding performance.[35] They are required to implement policies and procedures designed to

[35] *See, e.g., Clover Capital Mgmt, Inc.*, SEC No-Action Letter (Oct. 28, 1986).

ensure the accuracy and fairness of performance information. In addition, SEC-registered investment advisers are required to maintain full documentation of their performance calculations and supporting records. The SEC has also focused on ensuring oversight of the preparation of performance information and its presentation. The SEC inspection and enforcement divisions have made performance results a high priority focus area. For example, the SEC has implemented an Aberrational Performance Inquiry initiative to combat hedge fund fraud by identifying abnormal investment performance. [36]

Additional third party verification requirements would likely be costly, and given current regulations, an unnecessary expense for investment advisers (and their pool participants and other clients). Notably, the third party verification would not have addressed, and likely would not have prevented, the conduct exhibited in most of the MRAs in the past three years.[37] In addition, the CPO and CTA Disclosure Documents contain performance information, which NFA staff already reviews annually.

Verification of Pool Assets

The NFA has requested comment on whether it should require CPOs to report fund balances daily to the NFA. Daily or other reporting of account balances of pool assets is not needed and would be difficult to implement. If an investment adviser has custody, client assets are already verified pursuant to the Custody Rule, either through a surprise examination or as part of a GAAP audit. Auditors are required to verify assets by, among other methods, confirmation with the issuer of a security or with the counterparty to a derivative, confirmation of settled transactions with a broker-dealer or counterparty, physical inspection of a security or derivative contract, reading executed partnership or similar agreements, inspecting underlying agreements, and other forms of supporting documents.[38]

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[36] Under the initiative, the SEC Enforcement Division's Asset Management Unit uses proprietary risk analytics to evaluate hedge fund returns. Performance that appears inconsistent with a fund's investment strategy or other benchmarks forms a basis for further scrutiny. *See SEC Charges Multiple Hedge Fund Managers with Fraud in Inquiry Targeting Suspicious Investment Returns*, SEC. Rel. No. 2011-252 (Dec. 1, 2011), available at http://www.sec.gov/news/press/2011/2011-252.htm.

[37] In addition, the Global Investment Performance Standards ("GIPS") provide a stringent set of standards by which many large institutional asset managers show performance results to clients. *GIPS Guidance Statement on Verification*, effective Jan. 1, 2011. Third party verification is recommended, though not required, under GIPS. However, GIPS compliant firms must disclose whether the performance results are verified and whether a particular composite has been the subject of a performance examination. *GIPS Standard* 4.A.1. In the examination process, the SEC will often verify if advertisements are complying with GIPS if GIPS-compliant representations are made. If the NFA does proceed with adopting verification requirements, the rules should be harmonized such that there would be an exemption from the verification of performance results for NFA-member firms whose performance results are in fact verified as permitted by GIPS.

[38] *Privately Offered Securities under the Investment Advisers Act Custody Rule, Guidance Update*, Division of Investment Management, SEC No. 2013-04, 3 (Aug. 2013).

Further, robust reporting on Form CPO-PQR and NFA Form PQR provide additional information through which the NFA can assess the status of pool assets on a quarterly basis. The NFA should endeavor to digest and analyze all of the information to which it currently has access before deciding whether it needs to gather additional information.

Developing a system for the NFA to obtain balances from entities holding pool assets would be challenging. For example, if a pool trades more than exchange-traded futures, options and securities, the information necessary to obtain balances may not be obtainable through prime broker and other feeds (*e.g.*, uncertified securities, swaps and private placements). Given the wide range of types of funds, strategies, and holdings used by CPOs and CTAs, it would be more effective for the NFA to focus its efforts on fully considering the information currently available to it rather than develop and implement a new daily data feed system.

Inactive Members

We note that as a result of the rescission of CFTC Regulation 4.13(a)(4) and the changes to CFTC Regulation 4.5, many firms have registered as CPOs because they are uncertain as to whether they will continue to meet the *de minimis* tests in CFTC Regulations 4.5 and 4.13(a)(3) as the margin requirements for swaps may increase in the future. The fact that the CFTC has not finalized guidance regarding treatment of fund-of-funds circumstances adds to the uncertainty.[39] If the NFA adopts any requirements regarding the deregistration of inactive members, there should be a mechanism for an inactive member to justify its inactive status, which the NFA could verify in quarterly reports. In addition, the NFA should provide at least a one-year grace period for CPOs and CTAs to comply in order to ensure that persons do not have to register and deregister and then reregister as business changes or if a particular client account is opened or closed. In addition, a grace period would allow firms to determine if their registration is necessary given current regulatory uncertainty.

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The IAA appreciates the NFA's consideration of this letter. We look forward to working with you on these important issues. If you have questions or require further information, please contact the undersigned at (202) 293-4222.

Sincerely,

Karen L. Barr
General Counsel

[39] *See* CFTC Letter No. 12-38 (Nov. 29, 2012).

March 18, 2014

Via Electronic Mail

Mr. Gary Barnett
Director
Division of Swap Dealer and Intermediary Oversight

Mr. Vincent A. McGonagle
Director
Division of Market Oversight

Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Request for Interpretive Guidance and Relief on Application of Rule 1.35(a) to Asset Managers

Dear Mr. Barnett and Mr. McGonagle:

The IAA writes in support of the request made to you by SIFMA AMG and MFA in a letter dated December 10, 2013 (attached) for interpretive guidance that would exempt asset managers that participate on SEFs from the recordkeeping requirements of Commission Rule 1.35(a) for the reasons stated in the letter. We much appreciated the time-limited no-action relief issued by the DSIO and DMO on December 20, 2013 giving a commodity trading advisor that is a member of a SEF until May 1, 2014 to comply with the requirement under Regulation 1.35(a) to record oral communications. However, we would greatly appreciate your prompt consideration of the request to exempt asset managers that participate on a SEF from Rule 1.35(a) as outlined in the December 10 letter.

In particular, our members are facing lead-time issues in implementing infrastructure that may make the May 1 deadline extremely tight if not impossible. The time, effort, and costs involved in developing and implementing the appropriate systems and procedures to record oral communications are substantial. The right result for both interpretive and policy reasons would be for the Commission to expeditiously issue interpretive guidance clarifying that asset managers are not subject to the requirements of Rule 1.35(a), thereby obviating the need for our members to expend significant resources to come into compliance. In the meantime, however, because the May 1 deadline is fast approaching, we request that you extend the December 20 no-action relief compliance date of May 1 through December 31, 2014, as requested in the December 10 letter.

We would appreciate the opportunity to meet with you to discuss our concerns. In the meantime, please do not hesitate to contact me with any questions at 202-293-4222.

Best regards,

/s/ Karen L. Barr

Karen L. Barr
IAA General Counsel

sifma
Invested in America | asset management group

MANAGED FUNDS ASSOCIATION

17 C.F.R. §1.35(a)

December 10, 2013

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

Re: Request for Interpretative Guidance and Relief on Application of Rule 1.35(a) to Asset Managers

Dear Mr. Barnett:

The Asset Management Group ("**AMG**")[1] of the Securities Industry and Financial Markets Association ("**SIFMA**") and Managed Funds Association ("**MFA**")[2] (collectively, the "**Trade Associations**") request that the Commodity Futures Trading Commission (the "**Commission**") provide interpretative guidance and relief that would take one of the following forms, expressed in order of preference: (1) exempt Asset Managers[3] that participate on swap

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[1] AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The customers of AMG member firms include, among others, registered investment companies, ERISA plans and state and local government pension funds, many of whom invest in commodity futures, options, and swaps as part of their respective investment strategies.

[2] 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 o ther regions where MFA members are market participants.

[3] For purposes of this letter, Asset Managers ("**Asset Managers**") would include any person in the business of providing investment advice or advice regarding the value of securities or commodity interests for compensation and includes persons registered with the Securities and Exchange Commission or any U.S. state as an investment adviser under the Investment Advisers Act of 1940 (the "**Advisers Act**"), any person registered with the Commission as a commodity trading advisor ("**CTA**") or commodity pool operator ("**CPO**"), any person regulated by a foreign regulatory authority as an investment adviser and any person operating pursuant to an exemption or exclusion from registration with or regulation by any such regulators.

execution facilities ("**SEFs**") from the oral and the written recordkeeping requirements of Commission Rule §1.35(a) (the "**Rule**"); (2) suspend and re-propose the Rule as it applies to Asset Managers that may be treated as members of SEFs, including a detailed cost-benefit analysis that addresses application of the Rule to Asset Managers that are members of SEFs, and, if the re-proposed Rule is adopted, provide an implementation period of at least one year from the new adoption date; or, (3) if the Commission is unwilling to adopt either of the forgoing alternatives, postpone the compliance date of the Rule with respect to Asset Managers that are members of SEFs until December 31, 2014.

I. Background

The Commission proposed changes to its recordkeeping rules on June 7, 2011 (the "**Proposing Release**").[4] The Rule, as contemplated by the Proposing Release, applied to "futures commission merchants, retail foreign exchange dealers, introducing brokers, and members of designated contract markets or swap execution facilities"[5] and required the firms to maintain records of ***oral communications*** that lead to the execution of a swap and specified pre-trade and order-related ***written communications*** relating to swaps and related hedging transactions. The Commission published the final rules on December 21, 2012 (the "**Adopting Release**"), in substantially the same form as the proposed Rule, but with the addition of a new exemption from the oral recordkeeping requirements of the Rule for certain parties, including small introducing brokers ("**IBs**"), floor traders, swap dealers, major swap participants ("**MSPs**") and commodity pool operators ("**CPOs**").[6] During the comment period for the Proposing Release,[7] and as of the publication date of the Adopting Release, no SEFs yet existed[8] and none of the SEF rulebooks had been published. There was, therefore, no context or clarity around what it would mean to "have trading privileges" on a SEF and Asset Managers did not expect that they would be considered to be members of SEFs because they had access to SEFs.

Prior to publication of the amendments to the Rule and the Adopting Release, what it meant to be a member of a SEF was still unknown.[9] Because SEFs were a new type of

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[4] Adaptation of Regulations to Incorporate Swaps, 76 Fed. Reg. 33,066 (June 7, 2011).

[5] Proposing Release at 33,090.

[6] Adaptation of Regulations to Incorporate Swaps, 77 Fed. Reg. 75,523 (December 21, 2012).

[7] The comment period was from June 7, 2011 to August 8, 2011.

[8] The Commission approved the temporary registration of the first SEF, operated by Bloomberg, on July 31, 2013. As of the date of this letter, there are nineteen provisionally-registered SEFs. The majority of these SEFs (fifteen) became provisionally registered in September 2013. *See, e.g.,* http://sirt.cftc.gov/SIRT/SIRT.aspx?Topic=SwapExecutionFacilities.

[9] *See* Commodity Exchange Act ("**CEA**") §1a(34) ("the term 'member' means, with respect to a registered entity…, an individual, association, partnership, corporation, or trust – (A) owning or holding membership in, or admitted to membership representation on, the registered entity …; or (B) having trading privileges on the registered entity."). The CEA does not define the term "trading privileges," which added to the uncertainty regarding the definition of member of a SEF.

marketplace, it was not clear how they would operate or how membership would be defined.[10] Based on statements by members of the Commission itself, Asset Managers expected that SEFs would operate as platforms that allow "all market participants, not just dealers … [to] have the ability to compete in the marketplace."[11] The final SEF rules[12] recognized a distinction between members of a SEF and SEF market participants, thereby implying that not all users of a SEF would be considered members of the SEF. As a result of this distinction, Asset Managers believed that they would be able to participate on SEFs as market participants that would be fully subject to the SEF's jurisdiction, with membership status being reserved to intermediaries that facilitate transactions and provide market liquidity.

Then, over the past few months, SEFs began to publish their rulebooks. Most SEF rulebooks condition platform access on having "trading privileges" on the SEF, which by definition may make direct access to a SEF synonymous with SEF membership.[13] These rulebook provisions, therefore, conflate the definitions of a member and a market participant of a SEF. If any participant on a SEF that accesses the platform directly rather than through an intermediary would be a member of the SEF, then such participant could become subject to at least the written recordkeeping requirements of the Rule.

II. Request for Relief

We request interpretive guidance and relief that would confirm that those Asset Managers that participate on a SEF would not be members of a SEF for purposes of the Rule or otherwise

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[10] *See, e.g.*, Letter from Timothy Cameron, Managing Director, AMG, and Matthew Nevins, Managing Director and Associate General Counsel, AMG, to David Van Wagner, Chief Counsel, Division of Market Oversight, CFTC (Sept. 23, 2013), *available at* http://sifma.org/issues/item.aspx?id=8589945265.

[11] Gary Gensler, Chairman, CFTC, Keynote Address on the Cross-border Application of Swaps Market Reform at the Sandler O'Neill Conference (Jun. 6, 2013), *available at:* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-141; *See also* Statement of Chairman Gary Gensler to Open Commission Meeting for Consideration of Rules Implementing the Dodd-Frank Act, May 16, 2013 (referring to SEF trading rules and noting "These…rules together mean that anyone in the market can compete and offer to buy or a (sic) sell a swap and communicate that to the rest of the public….Market participants will benefit from the price competition that comes from trading platforms where multiple participants have the ability to trade swaps by accepting bids and offers made by multiple participants. Congress also said that market participants must have impartial access to these platforms.")

[12] Core Principles and Other Requirements for Swap Execution Facilities, 78 Fed. Reg. 33,476, 33,506 (Jun. 4, 2013) (the "**SEF Rules**"). *See* discussion on p. 33,506 ("In response to SIFMA AMG's comment about the ambiguous use of terms ["member" versus "market participant" in the context to SEFs], the Commission clarifies that 'market participant' … means a person that directly or indirectly effects transactions on the SEF. This includes persons with trading privileges on the SEF and persons whose trades are intermediated. The Commission also clarifies that 'member' has the meaning set forth in CEA §1a(34)").

[13] *See, e.g.*, Sample language from SEF rulebooks includes the following: "Each Participant shall have the right to access electronically the Platform, including the right to place Orders for each of its Proprietary Accounts and Customer accounts provided that such Participant is eligible for and has applied and received Trading Privileges." "'Participant' means any Person that has been granted, and continues to have, Trading Privileges under the …. Rules." "All Participants of … SEF shall have Trading Privileges on the … SEF which includes the right to access … SEF and enter orders for proprietary and customer accounts as authorized by the Participant's Participant Category."

exempt Asset Managers from application of the Rule. The Commission could base such exemptive relief on a clarification that the term members of SEFs would not include Asset Managers who trade on SEFs on a discretionary basis, in the name of their advisory clients (as opposed to intermediaries, who execute customer orders and provide market liquidity on SEFs to customers on an arms-length basis). Alternatively, the Commission could base the exemptive relief on policy considerations.

In the alternative, we request that the Commission take actions to allow all affected parties a fair and informed opportunity to evaluate and comment on the Rule. In order to accomplish this, we request that the Commission suspend application of the Rule (including both the written and oral requirements of the Rule) to Asset Managers that may be deemed to be members of SEFs and re-propose the Rule for comment. The Commission should include a comprehensive cost-benefit analysis that discusses application of the Rule to Asset Managers that may be deemed to be members of a SEF in the re-proposal. If, after evaluation of the comments, the Commission continues to believe that application of the Rule is appropriate to Asset Managers that may be deemed to be members of SEFs, it should provide a reasonable implementation period of at least one year from the new adoption date of the Rule for such Asset Managers.

If the Commission does not agree to exempt Asset Managers that are members of a SEF from the Rule or to suspend and re-propose the Rule as to those Asset Managers, it is critical that the Commission at the very least provide an implementation period of at least one year for Asset Managers that are members of a SEF to come into compliance with the Rule (including both the written and oral requirements of the Rule). As a result, we request that the Commission postpone the compliance date for the Rule, as it applies to Asset Managers that may be deemed to be members of SEFs, until December 31, 2014.

III. Discussion

1. The Commission Should Exempt Asset Managers that Participate on a SEF from the Oral and the Written Recordkeeping Requirements of the Rule

A. Asset Managers that Participate on a SEF Should Not Be Deemed to Be Members of a SEF for Purposes of the Rule

The Trade Associations believe that the Commission designed the Rule to apply to market intermediaries that execute customer orders and provide market liquidity to customers on an arms-length basis.[14] As a result, the references to members of SEFs in the Rule should not be interpreted to apply to Asset Managers that trade on a SEF with discretion on behalf of and in the name of advisory clients. Instead, the Rule should be interpreted to apply exclusively to market intermediaries. All of the entities explicitly named in the Rule (*i.e.*, FCMs, retail foreign exchange dealers, introducing brokers) are market intermediaries or "**Liquidity Providers.**" These intermediaries take orders from customers in connection with trade execution, provide two-sided markets and are paid transaction-based compensation. In addition, designated contract

[14] Adopting Release at 75,523-75,524.

market ("**DCM**") members also act in the capacity of market intermediaries and order execution agents for customers.[15]

Although most intermediaries are market makers, they all specialize in providing liquidity to customers as opposed to providing investment advice or trading expertise. This distinction, which we refer to as a distinction between "Liquidity Providers" (*i.e.*, professional market intermediaries) and "**Liquidity Takers**" (*i.e.*, end-users and their discretionary advisers and agents), was recognized and highlighted by the Commission in connection with defining the term "swap dealer."[16] In that regard, the Commission distinguished between "traders" and "dealers." As interpreted by the Commission, dealers' activities are distinguished by activities such as "providing liquidity by accommodating demand for or facilitating interest in the instrument, holding out as willing to enter into swaps (independent of whether another party has already expressed interest)," and acting as a market maker[17] on an organized exchange or trading system for swaps.[18] The Commission has noted that non-dealers, or traders, on the other hand, are "hedgers or investors"[19] and are not engaged in the business of seeking to profit by providing liquidity in connection with swaps.[20]

Interpreting the phrase "member of SEFs" to exclude Asset Managers trading on a SEF on behalf of discretionary customers is consistent with the types of records that the Rule seeks to collect. The Rule's recordkeeping requirements are focused on records "of all transactions relating to [the participant's] business of ***dealing*** in commodity interests and related cash or forward transactions."[21] Asset Managers participating on a SEF are not acting as dealers but instead are acting, with discretion, on behalf of and in the name of advisory clients.

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[15] The agency role that is contemplated for DCM members is evident in the CEA definition of "Organized Exchange." That definition provides that an "organized exchange" (which is synonymous with "DCM" in terms of swaps trading) is conducted by persons "by and on behalf of a person that is not an eligible contract participant or by persons other than on a principal-to-principal basis." CEA §1a(37).

[16] Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," Major Security-Based Swap Participant," and "Eligible Contract Participant," 77 Fed. Reg. 30,595 ("**Entity Definitions Adopting Release**") at 30,597.

[17] The Commission has illustrated the activities that constitute "making a market in swaps," which activities include: "(i) [q]uoting bid or offer prices, rates or other financial terms for swaps on an exchange; (ii) responding to requests made directly, or indirectly through an interdealer broker, by potential counterparties for bid or offer prices, rates or other similar terms for bilaterally negotiated swaps; (iii) placing limit orders for swaps; or (iv) receiving compensation for acting in a market maker capacity on an organized exchange or trading system for swaps." Entity Definitions Adopting Release at 30,609. These are not activities carried out by members of the Trade Associations, which typically act as "traders" or "Liquidity Takers" and not market makers, market intermediaries or Liquidity Providers.

[18] Entity Definitions Adopting Release at 30,608.

[19] *Id.* at 30,607 n. 172.

[20] *Id.* at 30,619.

[21] *See* Rule §1.35(a)(1) (emphasis added).

Differentiating between the taping and written records required to be maintained by intermediaries on a SEF and those acting as Liquidity Takers or traders, such as Asset Managers, would be consistent with the different recordkeeping requirements imposed by the Commission on swap dealers, on the one hand, and Asset Managers and other end-users in the over-the-counter swaps market on the other. As is the case in the over-the-counter swaps market, it is appropriate for the intermediaries that execute customer orders and provide two-sided quotes to retain records reflecting the details of the orders and pricing provided, whereas in the case of Asset Managers and other end-users the record that is critical to retain is the trade confirmation.

The Trade Associations believe that SEFs offer an important opportunity for Asset Managers to trade without intermediation by market professionals. This paradigm is consistent with the language in the SEF Rules that allows participants to trade uncleared swaps without intermediation by a futures commission merchant ("**FCM**").[22] It is inconsistent with this model to treat Asset Managers the same way as the enumerated market intermediaries are treated. As a result, the Commission should confirm that Asset Managers participating on SEFs would not be members of SEFs and, therefore, would not be subject to the Rule.

B. Asset Managers that Participate on a SEF Should be Exempted from the Rule for Policy Reasons

The Rule should not apply to Asset Managers when participating on a SEF for their advisory clients. Asset Managers must already keep sufficient materials for advisory clients and regulators to audit the fiduciary's activities and ferret out wrongdoing, mistakes or unusual trade patterns. For example, Asset Managers are already subject to extensive written recordkeeping requirements under the Advisers Act, the Employee Retirement Income Security Act of 1974, and CFTC Rule §4.33, which is applicable to CTAs that are registered or required to be registered under the CEA, among others. National Futures Association ("**NFA**") imposes oral recordkeeping requirements on member advisors that have a history of disciplinary problems.[23] These existing recordkeeping requirements, including requirements that advisors maintain both advisory client trading records and employee and firm trading records, provide regulators with substantially all of the information they would need to have a robust audit trail to guard against wrongdoing by Asset Managers and their personnel. The addition of further oral and written recordkeeping requirements for Asset Managers would be overly burdensome and expensive.

The records that Asset Managers must retain under existing rules primarily apply to post-trade or trade-entry information rather than pre-trade information, as covered by the Rule. However, we believe that the distinction between post-trade/trade-entry information and pre-trade information is appropriate because the audit trail for a fiduciary must substantiate performance and best-execution rather than order taking and order implementation practices, which are important for market intermediaries. Similarly, although Asset Managers registered under the Advisers Act must retain a memorandum regarding trade ideas and execution of the

[22] SEF Rules at 33,481 n. 88.

[23] NFA Rule 2-9 authorizes NFA's Board of Directors to prescribe "enhanced supervisory requirements" for certain member firms that exhibit certain "red flags."

trade ideas,[24] the information contained in these records is focused on trade execution and not on pre-trade conversations. Pre-trade information is essential in determining whether a market intermediary executes customer orders in an accurate and timely manner, but it is not useful in evaluating whether an Asset Manager has managed an advisory client's account in a profitable manner that complies with the advisory client's investment guidelines, which are the criteria on which the performance of an Asset Manager are primarily measured.

Furthermore, the majority of records cited in the Rule are the type of records that are produced by market intermediaries and not by Asset Managers. These records include order blotters, trading cards, street books, cancelled checks, signature cards, solicitations, instructions and communications provided concerning quotes, bids and offers. As a result, it does not seem as though the Rule was targeted to Asset Managers.

We also believe that the Commission will have sufficient access to information about trades conducted by Asset Managers on SEFs through regulation of other Commission registrants. For example, the Adopting Release specifically permits CTAs to rely on other Commission registrants to fulfill the oral recordkeeping obligation to the extent that taping by both parties would be duplicative.[25] Applying the Rule to Asset Managers that are members of SEFs will not enhance the enforcement tools and written and oral records already available to regulators as a result of existing recordkeeping requirements applicable to swap dealers and MSPs,[26] and the SEFs[27]and DCMs[28] themselves, as well as the market intermediaries that are subject to the Rule (*i.e.*, FCMs, introducing brokers). These entities are either on the opposite side of trades with Asset Managers or, in the case of SEFs or DCMs, represent the platforms on which they execute the applicable trades. Accordingly, subjecting Asset Managers to the requirements of the Rule would be duplicative in many respects.[29]

Application of taping and pre-execution recordkeeping requirements to Asset Managers that wish to participate on a SEF on an unintermediated basis rather than through an intermediary is likely to discourage Asset Managers from trading on SEFs directly. If the "cost" of accessing a SEF involves either paying a market intermediary for access to the SEF or, in the case of a

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[24] *See* Advisers Act Rule 204-2(a)(3).

[25] Adopting Release at 75,531 ("[C]overed persons may reasonably rely on a DCM, SEF or other Commission registrant to maintain certain records on their behalf…Reliance on a third party is only appropriate where the records maintained by the third party duplicate the information required to be kept by the regulation. For example, if an FCM records its telephone calls with a covered IB, the IB need not separately record the same calls if the IB and FCM agree that the FCM will maintain the record and provide access to the IB.").

[26] 17 C.F.R. § 23.202.

[27] 17 C.F.R. §§ 37.1000-37.1001 (requiring maintenance of transaction-related information in connection with all swaps executed on the facility).

[28] 17 C.F.R. §§ 38.950-38.951; 38.10 (requiring maintenance of transaction-related information in connection with all swaps executed on the facility).

[29] Although recordkeeping requirements for SEFs and DCMs do not cover all of the records identified by the Rule, they do include transaction-related information as well as related information regarding pricing and execution, which we believe are the most material elements of the information required by the Rule.

registered CTA that is a member of a SEF,[30] building an infrastructure to tape record all conversations "leading to execution of a swap" and, for all other Asset Managers, maintaining pre-trade written records relating to the swap and any related hedge, it is likely that many Asset Managers will elect not to access the SEF directly. Lack of direct participation of buy-side firms in the SEF marketplace is completely contrary to the result that Congress and the Commission were seeking to achieve, could weaken market integrity, inhibit price transparency and potentially reduce overall liquidity in the swap market. Accordingly, we believe that the Commission should issue the interpretative guidance and relief to exempt Asset Managers from the scope of the Rule in order to achieve Congress' goals related to providing open access to SEF platforms and price transparency.

2. <u>The Commission Should Suspend and Re-Propose the Rule as it Applies to Asset Managers that are Members of SEFs</u>

The Administrative Procedures Act (the "**APA**") requires that persons affected by a rulemaking have a fair opportunity to comment on the proposal.[31] The Commission did not provide reasonable notice to Asset Managers that it intended the Rule to apply to them if they elected to participate directly in trading on a SEF. The meaning of the term member of a SEF was not discussed in the Proposing Release or the Adopting Release and was not clear to the industry until recently.

Importantly, in the cost-benefit analysis provided, the Commission does not describe the size of the class of Asset Managers that it expected would be members of SEFs. For example, the Adopting Release indicates that entities subject to the Rule should expect to incur between $236,000 and $393,000 in compliance costs per entity per year as a result of the Rule, but it did not evaluate how those costs would affect Asset Managers that are SEF members.[32]

In light of the lack of reasonable notice as to the meaning of the term member of a SEF due to the adoption of the SEF Rules and release of SEF rulebooks months after adoption of the final Rule, the Trade Associations respectfully request that the Commission, consistent with its obligations under the APA, suspend the Rule as it applies to Asset Managers that may be members of SEFs and re-propose the Rule for comment. In addition, consistent with its obligations under §15(a) of the CEA, the Commission should "consider the costs and benefits of the action" proposed by the Rule[33] and its specific application to Asset Managers that are members of SEFs. We believe it is essential for the Commission to prepare and provide a revised cost-benefit analysis explaining the rationale behind application of the Rule to Asset Managers in light of the existing recordkeeping requirements to which such firms are subject as

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[30] The Commission has exempted certain entities, including CPOs and entities exempt from registration, from the oral recordkeeping requirements in Rule 1.35(a)(1)(v) and (viii).

[31] 5 U.S.C. § 553(b)(3)("either the terms or substance of the proposed rule or a description of the subjects and issues involved [must be provided]").

[32] Adopting Release at 75,540.

[33] CEA §15(a)(1), 5 U.S.C. §19.

well as the written and oral records already required to be maintained by FCMs and IBs trading with Asset Managers and the SEFs and DCMs themselves. If, after re-proposing the Rule with respect to Asset Managers that are members of SEFs and evaluating the comments, the Commission continues to believe that application of the Rule is appropriate to Asset Managers trading on a SEF for their advisory clients, it should provide a reasonable implementation period of at least one year from the date of adoption of the re-proposed Rule for Asset Managers that are members of a SEF to comply.

3. The Commission Should Postpone Compliance with the Rule for Asset Managers that are Members of SEFs until December 31, 2014

In the event that the Commission determines that it is necessary to subject Asset Managers to the Rule and elects not to suspend and re-propose the Rule, we request that the Commission postpone the compliance date for the Rule with respect to Asset Managers that are members of SEFs until December 31, 2014 to provide affected parties a reasonable period of time to comply with the Rule's requirements. Asset Managers will need time to implement the requirements of the Rule and evaluate how best to comply. Compliance may include revamping Asset Managers' current recordkeeping processes, engaging third-party service providers and/or building technology to comply with elements of the Rule, such as taping and record retention in the manner prescribed by the Commission, all of which will take a substantial period of time and resources. In addition, the Rule raises a number of difficult interpretive questions and uncertainties about its application and scope that Asset Managers will need time to address and better understand before they can fully comply.

IV. Conclusion

AMG and MFA hereby request that the Commission exempt Asset Managers that are members of SEFs from complying with the requirements of the Rule. If the Commission elects not to do so, we respectfully ask the Commission to suspend and re-propose the Rule as it applies to Asset Managers that are members of SEFs, including a detailed cost-benefit analysis, and, if the re-proposed Rule is adopted, provide an implementation period of at least one year from the date of adoption of the re-proposed Rule. In the event that the Commission is unwilling to adopt either of the foregoing alternatives, we request that the Commission postpone the compliance date for the Rule with respect to Asset Managers that are members of SEFs until December 31, 2014.

Based on the foregoing, we respectfully request that the Commission grant the interpretative guidance and relief described in this letter. The Commission is authorized to issue this guidance and relief under its general regulatory authority granted under §§4 and 5h of the CEA.

* * *

We appreciate your consideration of our request, and would be happy to provide any additional information or assistance that the Commission would find useful. Should you have any questions, please do not hesitate to contact Tim Cameron of AMG at 212-313-1389 or Matt Nevins of AMG at 212-313-1176, Stuart Kaswell of MFA or Laura Harper of MFA at 202-730-2600, or P. Georgia Bullitt of Morgan Lewis & Bockius LLP at 212-309-6683.

Sincerely,

/s/ Timothy W. Cameron, Esq.
Timothy W. Cameron, Esq.
Managing Director, Asset Management Group
Securities Industry and Financial Markets Association

/s/ Matthew J. Nevins, Esq.
Matthew J. Nevins, Esq.
Managing Director and Associate General Counsel, Asset Management Group
Securities Industry and Financial Markets Association

/s/ Stuart J. Kaswell
Stuart J. Kaswell
Executive Vice President, Managing Director and General Counsel
Managed Funds Association

cc: Hon. Gary Gensler, Chairman, Commodity Futures Trading Commission Hon.
Bart Chilton, Commissioner, Commodity Futures Trading Commission Hon.
Scott O'Malia, Commissioner, Commodity Futures Trading Commission Hon.
Mark Wetjen, Commissioner, Commodity Futures Trading Commission
Frank Fisanich, Chief Counsel, Division of Swap Dealer and Intermediary Oversight
Erik Remmler, Deputy Director, Division of Swap Dealer and Intermediary Oversight
Vincent McGonagle, Director, Division of Market Oversight
Nancy Markowitz, Deputy Director, Division of Market Oversight
Katherine Driscoll, Counsel, Office of the Chairman

Certification Pursuant to Commission Regulation §140.99(c)(3)

As required by Commission Regulation §140.99(c)(3), we hereby (i) certify that the material facts set forth in the attached letter dated December 10, 2013 are true and complete to the best of our knowledge; and (ii) undertake to advise the Commission, prior to the issuance of a response thereto, if any material representation contained therein ceases to be true and complete.

Sincerely,

/s/ Timothy W. Cameron, Esq.
Timothy W. Cameron, Esq.
Managing Director, Asset Management Group
Securities Industry and Financial Markets Association

/s/ Matthew J. Nevins, Esq.
Matthew J. Nevins, Esq.
Managing Director and Associate General Counsel, Asset Management Group
Securities Industry and Financial Markets Association

/s/ Stuart J. Kaswell
Stuart J. Kaswell
Executive Vice President, Managing Director and General Counsel
Managed Funds Association

March 11, 2014

Via Electronic Filing

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Proposed Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies and Request for Comment, File No. S7-08-13

Dear Ms. Murphy:

The Investment Adviser Association[1] appreciates the opportunity to comment on the publication by the Commission and other financial services agencies (the "Agencies") of the Proposed Interagency Policy Statement relating to the development of standards for assessing the diversity policies and practices of the entities that they regulate.[2]

The IAA and its members share the Agencies' commitment to the goals of diversity and inclusion that underlie section 342 of the Dodd-Frank Act, which establishes the Agencies' duties to develop standards in this area. Section 342 is intended to promote transparency and awareness of diversity and inclusion policies and procedures and provide guidance to regulated entities for assessing these policies and procedures. Diversity and inclusion provide opportunities for individuals and create stronger businesses, especially in our increasingly global economy. Thus, we support the goals of section 342.

[1] The IAA is a not-for-profit association that represents the interests of investment adviser firms registered with the Securities and Exchange Commission. The IAA's membership consists of more than 550 advisers that collectively manage in excess of $12 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations. For more information, please visit our website: www.investmentadviser.org.

[2] Proposed Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies and Request for Comment, SEC Rel. No. 34-70731 (October 22, 2013) (the "Policy Statement").

In carrying out their duties under this provision, however, the Agencies are instructed not to impose requirements on regulated entities.[3] The Policy Statement recognizes these limitations in stating that the Agencies will not use the examination or supervision process in connection with the proposed standards.[4] Although the statutory parameters of this provision are clear and the Policy Statement follows these parameters by implication,[5] we request that the Agencies reaffirm in their adopting release that the process of self-assessment described in the Policy Statement would be voluntary on the part of regulated entities.[6]

Given the specificity of the standards, the voluntary nature of standards and self-assessments is especially important for smaller firms. The investment adviser industry includes a full range of firms, from one- and two-person organizations to firms with thousands of employees. We therefore welcome the flexibility provided to investment advisers under the proposed standards and methods of assessment in addressing diversity and inclusion consistent with their unique characteristics, and request that this flexibility be reaffirmed in the Agencies' finalization of the standards.[7]

We appreciate the opportunity to provide our views on these issues and would be pleased to provide any additional information. Please contact the undersigned or Karen L. Barr, General Counsel, at (202) 293-4222 with any questions regarding these matters.

Respectfully submitted,

Kathy D. Ireland
Kathy D. Ireland
Associate General Counsel

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[3] Dodd-Frank Act § 342(b)(4).

[4] Policy Statement at 10.

[5] We note that the Policy Statement does not include the economic analysis, the Small Business Regulatory Enforcement Fairness Act discussion, or the Regulatory Flexibility Act scrutiny that would be required in a rulemaking. The Policy Statement does include a Paperwork Reduction Act statement that the proposed policy statement "contains no collections of information requiring approval by the Office of Management and Budget (OMB)."

[6] We also ask that the Agencies confirm that the scope of their assessments of regulated entities includes only their domestic operations, and that the Agencies act to protect the information in self-assessments voluntarily provided to the Agencies pursuant to the Freedom of Information Act, to enable candid and productive self-evaluations.

[7] Among other things, advisers would need flexibility as to the diversity practices of their "suppliers" under the standards, because such information most likely would not be readily available to advisers, especially as to third parties not involved in the advisers' provision of investment advice.

cc: The Honorable Mary Jo White, Chair
The Honorable Luis A. Aguilar, Commissioner
The Honorable Daniel M. Gallagher, Commissioner
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner

March 10, 2014

VIA ELECTRONIC MAIL

Ms. Melissa Jurgens
Secretary
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
Washington, DC 20581

Re: Request for Comment on Application of Commission Regulations to Swaps Between Non-U.S. Swap Dealers and Non-U.S. Counterparties Involving Personnel or Agents of the Non-U.S. Swap Dealers Located in the United States, 17 CFR Chapter 1

Dear Ms. Jurgens:

The Investment Adviser Association[1] appreciates the opportunity to comment on the applicability of Commodity Futures Trading Commission ("Commission" or "CFTC") regulations to activities in the United States of CFTC-registered swap dealers ("SDs") that are established in jurisdictions other than the United States.[2] We commend the Commission for deliberating on the matters addressed in the advisory issued by its staff, on November 14, 2013, with respect to these activities ("Staff Advisory").[3] We also welcome the Commission's efforts to work with its counterparts in Europe and elsewhere to provide much-needed pre-trade transparency to market participants. However, for the reasons set forth below, we request that the Commission not adopt the Staff Advisory as Commission policy.

The Staff Advisory was issued in response to concerns by certain swap market participants that the CFTC cross-border guidance may not specifically address swaps that are negotiated between a non-U.S. SD and non-U.S. counterparties acting through agents of the non-U.S. SD located in the United States. The Staff Advisory appears to be intended to address these concerns by requiring a non-U.S. SD (whether affiliates or not of a U.S. person)

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[1] The Investment Adviser Association ("IAA") is a not-for-profit association that represents the interests of investment adviser firms registered with the Securities and Exchange Commission. Founded in 1937, the IAA's membership consists of more than 550 firms that collectively manage in excess of $12 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations. For more information, please visit our website: www.investmentadviser.org.

[2] See Request for Comment on Application of Commission Regulations to Swaps Between Non-U.S. Swap Dealers and Non-U.S. Counterparties Involving Personnel or Agents of the Non-U.S. Swap Dealers Located in the United States, 79 Fed. Reg. 1347 (Jan. 8, 2014).

[3] See Division of Swap Dealer and Intermediary Oversight, Applicability of Transaction-Level Requirements to Activity in the United States (Nov. 14, 2013).

that regularly uses personnel or agents located in the U.S. to "arrange, negotiate, or execute swaps with non-U.S. persons" ("covered transactions") to comply with the CFTC regulations applicable on a transaction-by-transaction basis ("transactional requirements"). The Staff Advisory further states that this view applies to a covered transaction booked in a non-U.S. branch of the non-U.S. SD. Finally, the Staff Advisory does not permit substituted compliance with comparable regulations of foreign countries.

As discussed further below, we are concerned that the Staff Advisory may have negative unintended consequences for non-U.S. clients of asset management firms.[4] We believe the CFTC staff may not have sufficiently considered the potential costs and benefits of its Advisory for non-U.S. investors and their U.S. asset managers. In addition, we submit that the staff should have permitted substituted compliance. Finally, we respond to the Commission's request for comment regarding the range and types of U.S. activities that would subject non-U.S. SDs to CFTC regulation in this context.

The Staff Advisory may have negative implications for non-U.S. clients of U.S. asset managers.

We are concerned about the effect the requirements imposed by the Staff Advisory would have on non-U.S. investors, many of whom are clients of U.S. asset management firms or of non-U.S. asset management firms with affiliates or personnel in the U.S. It is typical for global swap desks at many SDs to provide non-U.S. clients with 24-hour access to U.S. swap markets and staff located in the U.S. The use of swap dealers with global operations facilitates global trading and manages time zone issues in a way that is seamless and benefits these clients. In addition, a U.S. asset manager or the U.S. affiliate of a non-U.S. manager may call U.S. personnel of a non-U.S. SD to request that a trade be placed, to gather current information on pricing, liquidity or other market color, or to ask servicing-related questions. These asset managers may also call U.S.-based personnel with expertise or knowledge of U.S. swaps markets based on existing relationships. For example, the asset manager may want to trade in swaps with a U.S. underlying asset on behalf of their non-U.S. clients where the expertise of U.S.-based personnel would be particularly valuable.

Moreover, non-U.S. clients engaging in swap transactions with non-U.S. SDs may have no expectation that their transactions would be subject to U.S. regulation. Indeed, it is

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[4] We are also concerned that the Staff Advisory is inconsistent with the CFTC's jurisdictional limitations mandated by Congress. Section 2(i), added by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") [Public Law 111-203 (July 21, 2010)], states that the swaps provisions of the Commodity Exchange Act ("CEA") do "not apply to activities outside the United States unless those activities have . . . a direct and significant connection with activities in, or effect on, commerce of the United States . . . ." See 7 U.S.C. 2(i). This provision limits the authority of the CFTC with respect to extraterritorial application of the CEA's swaps provisions. We agree with other commenters that Section 2(i) requires the Commission to clearly articulate that the "direct and significant" standard has been satisfied in order to apply CFTC regulations to swap activities that take place outside the United States. However, the discussion in the Staff Advisory fails to address this standard.

possible that a non-U.S. SD may use U.S. personnel and the asset manager investing on behalf of non-U.S. clients may not know if and when these persons are involved. If the Staff Advisory is adopted, non-U.S. clients would be (in some cases unexpectedly) required to enter into specified protocols and have their transactions subject to a potentially additional layer of regulation that may impose additional costs and burdens on these clients. In the alternative, non-U.S. SDs may incur the expense of moving their personnel from the U.S to another location in North America (e.g., Canada) in order to address the implications of the Staff Advisory for their non-U.S. investors. Non-U.S. SDs may also incur the expense to hire dedicated personnel already located outside the U.S. to work during U.S. market hours to provide coverage of U.S. swap markets. Under either approach, these non-U.S. SDs would be faced with the burdens and costs of developing separate compliance systems and operations for swap transactions with non-U.S. counterparties. We are especially concerned that increased expenses for the SD would ultimately result in increased transaction costs and reduced services for our members' non-U.S. clients. Further, we are concerned that these issues may cause non-U.S. clients to avoid hiring U.S. asset managers due to perceived impediments involved in dealing with only non-U.S. personnel of non-U.S. SDs. Therefore, we urge the Commission to fully consider the potential costs and benefits that would result from imposing U.S. regulations on non-U.S. market participants (including investors) as contemplated by the Staff Advisory.

The Staff Advisory should have permitted substituted compliance.

To the extent the Commission determines that it should impose transactional requirements on non-U.S. SDs when entering into covered transactions, we urge the Commission to permit non-U.S. SDs to be able to rely on the CFTC's substituted compliance framework. Last year, the Commission provided interpretative guidance on the application of provisions relating to swaps in Title VII of the Dodd-Frank Act, and CFTC regulations adopted thereunder, to activities outside of the United States ("Guidance").[5] Specifically, the Guidance addresses which swap activities outside the United States are subject to CFTC jurisdiction under Section 2(i) of the CEA.

In issuing the Guidance, the Commission stated that "in exercising its authority with respect to swap activities outside the United States, the Commission will be guided by international comity principles."[6] In this regard, the Commission's Guidance also addresses the circumstances under which the transactional requirements could be satisfied through substituted compliance with applicable foreign regulation. Notably, the Guidance provides that substituted compliance should be available for transactional requirements with respect to swaps between a non-U.S. SD and a non-U.S. person, or should not apply at all, depending on

[5] See Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations 78 FR 45292 (July 26, 2013).

[6] See 78 FR at 45297.

whether or not such non-U.S. person is a guaranteed affiliate or affiliate conduit of a U.S. person.[7] According to the Commission, swap transactions "should be eligible for substituted compliance with respect to [transactional requirements], to the extent applicable, in light of the supervisory interest of the foreign jurisdiction in the execution and clearing of trades occurring in that jurisdiction."[8]

The Commission further stated that any approach to substituted compliance "would be expected to mitigate any burden associated with potentially conflicting foreign regulations and would generally be appropriate in light of the supervisory interests of foreign regulators in entities domiciled and operating in its jurisdiction."[9] As such, the Guidance provided by the Commission appears to indicate that substituted compliance should generally be available for foreign swap transactions involving solely non-U.S. counterparties and a non-U.S. SD.

We acknowledge the Commission's need to balance the important policy goals of the Dodd-Frank Act and take into consideration counterparty protection, transparency, systemic risk, liquidity, efficiency, and competition in the market. We also appreciate the CFTC's continued efforts to avoid having market participants subject to conflicting or duplicative regulations. However, we believe that the Staff Advisory is fundamentally inconsistent with these efforts. By not permitting substituted compliance for these foreign swap transactions, the guidance provided by the Staff Advisory reflects a lack of coordination with foreign regulators that would inevitably lead to less efficient use of regulatory resources and would likely subject the affected entities to potentially duplicative or conflicting regulations and increased costs of compliance. Moreover, the Staff Advisory appears to not consider the supervisory interest of foreign regulators with respect to swap transactions involving entities operating within its jurisdiction and the investor protection interests of such regulators with respect to its resident investors. Therefore, the IAA urges the Commission to recognize the supervisory interest of foreign regulators and permit substituted compliance of swap transactions involving non-U.S. counterparties and a non-U.S. SD.

Any Commission policy affecting non-U.S. investors should provide clarity with respect to the range and types of transactions that would be covered.

In light of the increasingly complex nature of the derivatives markets, especially with all the new regulations facing market participants, it is vital for the Commission to provide clarity with respect to its regulations and address areas of uncertainty for all market participants. The Staff Advisory sets forth the criteria that persons "regularly arranging, negotiating, or executing" swaps for or on behalf of an SD are "performing core, front-office

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[7] See 78 FR at 45350-59.

[8] See 78 FR at 45327.

[9] See 78 FR at 45301.

activities of the SD's dealing business" that should be subject to CFTC transactional requirements. Neither the Guidance nor the Staff Advisory offer clarity in this regard.

We understand that the Staff Advisory may not intend to impose transactional requirements for activities in the U.S. that are nominal or tangential to foreign swap transactions.[10] However, we believe that the terms "arranging" and "negotiating" are overly broad and may encompass activities that are incidental to a swap transaction. We are also concerned that the terms "core" and "front-office" are too vague in this context and would result in differing interpretations by market participants. Activity-based regulations that are unclear often result in market participants avoiding the underlying activities altogether. As such, we believe that the adoption of these criteria by the Commission would have the unintended consequence of deterring activities by non-U.S. SDs in the U.S. that the CFTC may not have intended to be covered transactions.

Further, we note that trade compliance and governance are the responsibility of the counterparty to the transaction regardless of where the counterparty's agents or affiliates may be located. The IAA would therefore recommend that the Commission not use the criteria set forth in the Staff Advisory. At most, if the Commission determines to proceed with its "territorial" approach, it should limit covered transactions to only those where the principal activities of execution and/or clearing of the trade occur in the United States. We would suggest that limiting covered transactions in this manner would provide clarity for all market participants while considering the CFTC's supervisory interests of efficiency and competition in the market.

However, should the Commission determine to adopt the Staff Advisory, we would urge the Commission to clearly describes the types of activities in the U.S. that would subject transactions between non-U.S. SDs and non-U.S. counterparties to CFTC transaction-level requirements. In particular, we would urge the Commission to clarify that the sales activities of a non-U.S. SD conducted in the U.S. in connection with a swap transaction with a non-U.S. counterparty would not be deemed to be "arranging" or "negotiating" swaps and therefore would not be "core front office" activities. Moreover, we would suggest specifically excluding from covered transactions activities of U.S. personnel that relate to providing market and pricing information or other similar activities that would be incidental to the swap transaction.

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The IAA appreciates the Commission's consideration of our comments on the application of Commission regulations to transactions between non-U.S. SDs and non-U.S. counterparties. We encourage the Commission to continue to coordinate with other regulators

[10] We also do not believe that Congress intended that nominal or tangential activities that take place in the U.S. in connection with a swap transaction between a non-U.S. SD and a non-U.S. counterparty be deemed to have a "direct and significant connection" with commerce of the United States. See supra note 4.

in developing its cross border regulatory framework. Please contact the undersigned or Karen Barr, IAA General Counsel, at (202) 293-4222 if we may provide any additional information regarding our comments.

Sincerely,

/s/ Sanjay Lamba
Assistant General Counsel

cc: The Honorable Mark P. Wetjen, Acting Chairman
The Honorable Bart Chilton, Commissioner
The Honorable Scott D. O'Malia, Commissioner

March 5, 2014

Via Electronic Mail

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission of New Brunswick
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Registrar of Securities, Nunavut

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Re: Proposed Amendments to National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations

Dear Madame Beaudoin and Mr. Stevenson,

The Investment Adviser Association (IAA)[1] welcomes the opportunity to comment on Proposed Amendments to National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations. The IAA is a not-for-profit U.S. association that represents the interests of investment adviser firms registered with the U.S. Securities and Exchange Commission (SEC). The IAA's members manage assets for a wide variety of institutional and

[1] For more information, please visit our website: www.investmentadviser.org.

individual clients, including pension plans, trusts, investment funds, endowments, foundations, and corporations. Many of our members manage assets on behalf of clients in Canada and some of our members are located in Canada.

We appreciate and support the efforts of the Canadian Securities Administrators (CSA) to provide increased uniformity in the areas of registration and regulation of investment advisers. The IAA is providing comments we believe the CSA should consider in adopting any proposed changes.

Support for Increased Uniformity for the International Sub-Adviser Exemption

The proposed International Sub-Adviser Exemption would establish a new uniform exemption from registration for international sub-advisers providing advisory services in Canada to lead advisers or dealers registered under NI 31-103, provided the sub-adviser meets the following criteria: (1) the sub-adviser and the registered adviser enter into a written agreement, (2) the registered adviser in turn enters into a written agreement with its clients whereby it agrees to be responsible for any losses arising out of the sub-adviser's failure to provide its services honestly, in good faith and in a reasonable manner, and (3) the sub-adviser has no direct interaction with clients without the registered adviser also being present or capable of real-time participation ("chaperoning"). The sub-advisers must also be headquartered in a foreign jurisdiction, be registered or exempt from registration in that jurisdiction, and act as an adviser there.

The IAA supports the increased uniformity that the proposed international sub-adviser exemption will provide. The exemption will provide a practical means by which foreign sub-advisory firms can more easily provide their expertise to the Canadian markets while helping ensure that the ultimate Canadian investors are adequately protected. The lead advisers will be appropriately incentivized to perform substantive due diligence on foreign sub-advisers under this provision because they will have contractually agreed with their own clients to cover losses stemming from malfeasance on the part of the sub-adviser and the sub-adviser will remain subject to their oversight.

The IAA recognizes that any uniform sub-adviser exemption should incorporate investor protections. We respectfully submit, however, that the CSA reconsider the chaperoning requirements, which may hamper investor-desired communications with foreign sub-advisers regarding their portfolios. It is costly and burdensome to establish structures and procedures to implement the chaperoning requirements. Further, we are not aware of problems caused by sub-adviser communications in jurisdictions that do not currently require chaperoning, such as Quebec and Ontario. As noted above, under the sub-adviser exemption, the lead adviser is entirely responsible for a sub-adviser's breach of its duties of good faith and due care, and thus must develop policies and procedures to supervise the sub-adviser's activities, including oral and written communications with clients. Specific chaperoning requirements add little in the way of additional investor protection, while creating significant logistical burdens, and indirect costs, when the ultimate client wants to discuss matters such as portfolio performance with the sub-adviser by requiring either three-party in-person meetings or phone calls. Moreover, because the chaperoning requirement also extends to written communications, and the proposed Companion

Policy suggests that sub-advisers may not send communications directly to the registrant's clients but rather, such communications must come from the registrant itself (*e.g.*, the sub-adviser would not be permitted to communicate directly and copy the registrant on the communication), international sub-advisers may face additional burdens in meeting regulatory disclosure delivery and other reporting requirements of their home jurisdiction.

Support for Registered Sub-adviser Relief

The CSA proposes to revise section 13.17, which limits client obligations of registered sub-advisers under the conditions outlined above in the proposed international sub-adviser exemption: (1) a written agreement between the registered lead adviser and the sub-adviser; (2) a written agreement between the lead adviser and its clients whereby the lead adviser assumes responsibility for sub-adviser breaches of good faith and due care duties; and (3) chaperoning.

The CSA proposes relief whereby a registered sub-adviser taking such steps would be exempt from certain requirements with respect to its relationship with the client/lead adviser—such as identifying and responding to conflicts of interest, providing certain notices, and responding to complaints. The IAA supports this proposed relief because, as the CSA appropriately recognizes, the dynamic between a sub-adviser and a registered lead adviser is fundamentally different from typical relationships between investment advisers and their clients. The relationship benefits from the higher level of sophistication of both parties, the cooperative efforts by both parties on behalf of third-party clients, and the obligations already shouldered by the lead adviser. These criteria help ensure that the lead adviser is both capable and incentivized to perform necessary due diligence so as to protect its own interests when hiring a qualified sub-adviser. Thus, the relief appropriately streamlines or eliminates certain requirements that are unnecessary, or are duplicative of obligations already required of the lead adviser with respect to its clients.

Concerns Regarding Impact of Amendments to International Adviser and International Sub-Adviser Exemptions on Registrants

The IAA opposes proposed sections 8.22.2 and 8.26.2, which would prohibit use of the international adviser exemption for any advisers that are already registered in one province and seek to provide advisory services in another province. These international advisers would otherwise be eligible to avail themselves of the exemption if they were not already registered in one province. The IAA is also concerned that the proposed international sub-adviser exemption would only be available to those advisers that are not registered in any Canadian jurisdiction.[2]

There are many legitimate reasons why an adviser would be registered in one jurisdiction and then seek to take advantage of the exemption in another province. For example, an international adviser may choose to register in a jurisdiction where it serves one or more very large clients, but also advises or sub-advises a few accounts in other jurisdictions where it relies on the exemption. Similarly, a Canadian-registered firm may have certain clients that insist on

[2] We are also concerned with respect to the parallel proposal regarding the international dealer exemption, as an adviser's affiliated entity may rely on the exemption in one or more provinces to conduct certain marketing activities of non-Canadian funds managed by the adviser.

registration in their jurisdiction while clients in other jurisdictions do not. Or, sub-advisers may want to have direct contact with a client in one province but are willing to work through a lead adviser with others in other provinces.

Given these legitimate and varied reasons, there is no compelling policy reason to prevent international registrants from availing themselves of the exemption solely because of registration in one jurisdiction. The CSA made the policy decision to adopt an international adviser exemption with substantial conditions, including a maximum threshold of 10% of aggregated gross income from Canadian portfolio management activities. We are aware of no evidence that an adviser that is registered in one province would pose investor protection issues by acting in an exempt capacity in another jurisdiction. The CSA cited potential investor confusion, but provides no empirical evidence of such issues. In fact, NI 31-103 already requires advisers relying on the international adviser exemption to provide notice to investors in the provinces in which they claim the exemption informing them of their exempt status. If investors are found to be confused by this situation, transparency and disclosure are more tailored, cost-effective solutions than registration in multiple provinces.

While Canadian investors would not be advantaged by requiring otherwise unneeded registration, the proposal would impose additional burdens on those entities that are already subject to Canadian regulation. Indeed, registrants' additional registration burdens may be challenging and costly. Advisers would be required to pay additional fees and expend time and resources complying with non-uniform requirements or uniform requirements implemented differently in various provinces. For example, there may be additional requirements for individual portfolio managers in one jurisdiction but not others. Both firms and individual managers may face significant financial, time, and other burdens trying to meet each province's proficiency standards, and other specific requests. Certain provinces apply their own perspective in reviewing firms' policies and procedures upon registration or thereafter. An investment advisory firm registered in a province that has accepted one set of policies and procedures may have to assess whether to take the significant step of adapting its policies and procedures to another province's requirements, comments, or particularities.

For these reasons, many registered firms may contemplate limiting Canadian business or even deregistration to utilize the international adviser or sub-adviser exemptions. This result would disadvantage smaller Canadian clients or clients in smaller provinces if advisers choose not to register in order to service a one-off or small client in a province that requires another set of registrations. These other Canadian clients may thus be deprived needlessly of specialized expertise offered by U.S. or other international advisers or sub-advisers. Accordingly, we strongly urge the CSA not to adopt proposed sections 8.22.2 and 8.26.2.

Support for Reversion Back to "Permitted Client" Conditions for the International Adviser Exemption

Under current rules adopted in 2011, an "international adviser" availing itself of the international adviser exemption may only advise "Canadian permitted clients." Thus various categories of otherwise permitted clients must have Canadian citizenship or residency (for individuals) or Canadian incorporation or organization (for corporations and other business

entities). The 2011 change was more restrictive than had been originally intended. All of the CSA members, other than the Ontario Securities Commission, have issued parallel orders that allow a person to rely on these exemptions as if the term "Canadian permitted client" read "permitted client." The CSA now seeks, through the proposed changes, to formally revise sections 8.18 (international dealer) and 8.26 (international adviser) to revert back to the less restrictive "permitted client" conditions in these exemptions that were in force prior to July 11, 2011. The IAA supports these proposed revisions to sections 8.18 and 8.26 to reverse the inadvertent negative effects of the 2011 amendments for the reasons stated by the CSA.

In response to Ontario's specific request for comment, we are not aware of circumstances where these exemptions are being used by foreign entities located in Canada to provide services to investors outside of Canada. While we understand Ontario's interest in trying to preserve its jurisdiction from disrepute caused by potential abuse of its international exemption, we believe Ontario's concerns are remote and would not be impacted by the proposed change. In any event, if there is a possible fraud operating out of its jurisdiction against foreign permitted clients, Ontario would have at its disposal all of its legal and regulatory tools to take appropriate action.

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We appreciate the opportunity to provide our views on these issues and would be pleased to provide any additional information. Please contact Paul Glenn or me at (202) 293-4222 with any questions regarding these matters. Thank you for considering our views.

Respectfully Submitted,

Karen L. Barr
General Counsel

February 25, 2014

Via Electronic Mail

Adam Wreglesworth
Wholesale Conduct Policy & Client Assets
Markets Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Re: FCA Consultation Paper CP13/17 (November 2013)

Dear Mr. Wreglesworth:

The Investment Adviser Association (IAA) appreciates the opportunity to comment on Consultation Paper 13/17, relating to the use of dealing commission rules.[1] The IAA is a not-for-profit US association that represents the interests of investment adviser firms registered with the US Securities and Exchange Commission (SEC). Our membership consists of investment advisory firms that manage assets for a wide variety of institutional and individual clients, including pension plans, trusts, investment funds, endowments, foundations, and corporations, and many of our members manage, or have affiliates that manage, assets for UK clients.[2]

Investment advisers in the US are subject to a fiduciary standard in the management of their clients' assets, which encompasses the important principles of trust, loyalty, and duty of care. Our members must act in the best interests of clients and place the interests of clients before their own. This duty is over-arching and includes transparency, particularly the duty to disclose, among other things, potential conflicts of interest that may arise in the course of their services. We therefore support transparency in advisers' dealings with clients. We have concerns, however, about the specific changes proposed in the Consultation Paper, including whether they would ultimately benefit clients.

[1] FCA Consultation Paper, CP13/17 (November 2013) (Consultation Paper).

[2] For more information, please visit our website: www.investmentadviser.org.

Introduction

The Consultation Paper discusses proposed changes to the Conduct of Business sourcebook (COBS) that would amend the rules governing the use of dealing commission by investment managers. Under the current version of COBS 11.6, an investment manager generally cannot accept additional goods or services in connection with the execution of client orders. The COBS includes an exemption from the general rule, however, for goods or services "if the investment manager has reasonable grounds to be satisfied that the goods or services received in return …comprise the provision of research" and "will reasonably assist the investment manager in the provision of its services to its customers on whose behalf the orders are being executed and do not, and are not likely to, impair compliance with the duty of the investment manager to act in the best interests of its customers."

The changes proposed in the Consultation Paper would alter significantly an investment manager's analysis of its use of dealing commission in a number of ways, and extend far beyond the treatment of corporate access and market data services, which are highlighted in the Consultation Paper. Our comments primarily relate to (1) the proposed elimination of the "reasonable grounds" standard under which investment managers currently assess the permissibility of the use of client dealing commission under COBS 11.6.3R; and (2) the implications of the proposed changes for investment managers that do business on a global basis.

Elimination of the "Reasonable Grounds" Standard

We are concerned about the implications of the proposed elimination of the "reasonable grounds" standard and the substantial change that this amendment would represent. As noted above, the current COBS provides that the research exemption applies "if the investment manager has reasonable grounds to be satisfied that the goods or services received in return …comprise the provision of research." Under the proposed new formulation, the reference to "reasonable grounds" would be eliminated, and a form of strict liability could be imposed on investment managers that made an incorrect determination of the eligibility of a particular good or service for the exemption, regardless of the good faith of the manager or the grounds for its determination.

The IAA views this elimination as a substantial change that goes well beyond the clarification of existing rules. The body of the Consultation Paper does not discuss or explain the reasoning behind the elimination of this language. Given the broad variety of goods and services that could potentially constitute research under COBS 11.6.3R, and difficulty of drawing a bright-line between permitted research and other goods and services that do not fall

within the exemption, a strict liability standard would not be appropriate in this context.[3] Furthermore, the proposed changes would establish a presumption that a specific use of dealing commission was not exempt. The Consultation Paper explains that "[t]his would clarify the perimeter of the regime by introducing a presumption of a breach of the rules if the cumulative criteria are not met." Adding this presumption to the elimination of the reasonable grounds standard would establish unwarranted barriers to investment managers' access to research, and could raise the fees paid by UK clients if managers passed on the cost of research. The changes would be especially far-reaching when combined with other proposed changes to the COBS.

Corporate Access

For example, the proposed inclusion of corporate access services in the list of examples of services that do not constitute research would require an investment manager to determine whether a particular service constituted a "corporate access service." This term would be defined in the proposed changes as "a service of arranging or bringing about contact between an investment manager and an issuer or potential issuer." In its discussion of corporate access services in the body of the Consultation Paper, however, the FCA notes that broker research offered in addition to the arranging service ("such as a briefing note or a research analyst's input before a meeting") "may be capable of being reasonably judged by the investment manager as chargeable to dealing commission under the exemption." Under the strict liability that the proposed revisions to the COBS could impose if adopted unchanged, the investment manager would designate this aspect of the service as constituting research at its own peril in the event that the FCA ultimately disagreed, regardless of whether this analysis had been undertaken in good faith and the investment manager had reasonable grounds to reach its conclusions. This change would have real practical consequences, for example, for broker-arranged events and meetings such as non-deal roadshows and conferences that may have heavy broker research content throughout, but also involve meetings with company management.

Proposed New COBS 11.6.8A

The elimination of the "reasonable grounds" standard and the presumption of breach of the rules could also impact the investment manager's duties under the proposed new COBS 11.6.8A. This provision would alert managers that in using dealing commission for research services they should (1) compare the costs to what they would pay directly for such services; (2) negotiate or dictate the price of the good or service, if in a position to do so; and (3)

[3] We note that the US statute governing the use of "soft dollars," section 28(e) of the Securities Exchange Act of 1934, uses a "good faith" standard in describing the required determination on the part of an investment manager that the amount of commission is "reasonable in relation to the value of the brokerage and research services provided" in a similar context. *See* 15 U.S.C. § 78bb.

disaggregate various services in the "mixed use" context. All of these undertakings would necessitate access to information about the costs of such services, but some of this information might not be available to the manager, especially in the context of the "mixed use" analysis of corporate access and market data services.

For example, this proposal incorrectly assumes that there is an established market for every service with a "hard" cost, and that brokers are willing to provide this information. This misconception is particularly significant in the context of corporate access services, but applies in other contexts as well, especially as to proprietary research. Managers would face difficulties in documenting compliance with these requirements, because brokers do not have an established means for valuing corporate access and/or research. In addition, some brokers may not cooperate in providing a value or even accept payments from an investment manager's own resources for such services. Even if brokers provided estimated prices for these services, prices among brokers would inevitably vary, depending on the methodologies and assumptions underlying the estimates.

Further, investment managers would face substantial challenges in documenting whether and to what extent they are in a position to negotiate with brokerage firms. Here too, investment managers that undertake these analyses, which would require extensive data-gathering and recordkeeping, would face heightened liability risks under the proposed changes to the COBS, if the FCA disagreed with their analysis. In addition, the cumulative effect of these changes could require investment staff to spend a disproportionate percentage of their time on documentation of limited utility, to the detriment of their investment research and analysis. While we understand the FCA's intent in ensuring that managers "seek to control costs to clients with as much rigour as they pursue investment returns," we submit that a client who hires an investment manager would prefer that the manager focus primarily on delivering strong investment performance (including performance net of costs, a calculation that already provides managers with strong incentives to control costs).

In addition, we note that the cost-benefit analysis of the proposed changes does not discuss the impact of the elimination of the "reasonable grounds" standard. The proposed changes would affect only the responsibilities of investment managers, and not impose any responsibility on the brokers providing the research to provide information concerning pricing. The lack of transparency on the part of brokers would make the costs to investment managers of complying with the proposed changes even more substantial. Furthermore, the increased compliance burdens under the proposed changes would fall disproportionately on small and medium-sized managers.

We therefore request that the "reasonable grounds" standard remain in the COBS and that the new language establishing a presumption of breach not be added. Further, we urge the FCA to consider requirements mandating that brokers provide investment managers with the information they need to comply with the FCA's rules on the use of dealing commission.

Implications for Managers Doing Business on a Global Basis

Finally, we note that many investment managers operate their businesses and provide their services on a global basis, and the proposed standards would not be consistent with those of other jurisdictions, including the US. For example, the US Securities and Exchange Commission in its 2006 guidance concerning the scope of section 28(e) "soft dollar" safe harbor under the Exchange Act of 1934 stated that (1) meetings with corporate executives to obtain oral reports on the performance of a company are eligible for the safe harbor; and (2) market data, such as stock quotes, last sale prices, and trading volumes, are eligible as "research services" under the safe harbor.[4] In the case of corporate access, the SEC reasoned that "[m]eetings with corporate executives to obtain oral reports on the performance of a company are eligible because reasoning or knowledge will be imparted at the meeting (i.e., reports) about the subject matter of Section 28(e) (i.e., concerning issuers)." Similarly, the SEC supports the treatment of the provision of "raw" market data as research: "In our view, this approach will promote innovation by money managers who use raw data to create their own research analytics, thereby leveling the playing field with those money managers who buy finished research, which incorporates raw data, from others."[5]

The establishment of UK rules that differ from other jurisdictions could disadvantage UK clients, and/or discourage investment managers from offering their services in the UK. For example, many managers place their orders for securities transactions on a "block" basis, which generally benefits their clients, and orders from UK firms may be aggregated with orders from non-UK affiliates in a group that uses a fully integrated trading and research platform. This practice aims to achieve economies of scale and to treat orders from different clients equitably. If the commissions related to these orders *may* be used for services that *might* not qualify for the exemptions set forth in the COBS, for example, because information on the cost breakdown is not available from a non-UK broker (and the manager cannot rely on a good faith or reasonable analysis, under the changes proposed in the Consultation Paper), managers may feel compelled to separate out UK clients from these otherwise advantageous arrangements.[6] If UK rules are not harmonized with those in other jurisdictions, the result could disadvantage UK clients, and present practical, logistical, and client relations issues.

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[4] *See* U.S. Securities & Exchange Commission, Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, Rel. No. 34-54165 (July 18, 2006).

[5] The SEC also noted that "excluding market data from the safe harbor could become meaningless if it encouraged purveyors of this information to simply add some minimal or inconsequential functionality to the data to bring it within the safe harbor." Id.

[6] We note that the limitations on aggregating account trades under COBS 11.3.7R generally allow aggregation only where such aggregation would benefit the client; therefore, not allowing otherwise advantageous aggregation would operate to disadvantage UK clients.

In the alternative, investment managers may opt not take on UK clients, if the managers determine that they cannot provide the same benefits to UK clients as they can provide to their other clients. Either result could ultimately disadvantage UK clients. Under certain circumstances, managers may not be able to effectively "ring fence" the arrangements for UK clients without potentially negative consequences. Therefore, we urge the FCA to reassess and revise the proposed changes, and allow investment managers the opportunity to provide further comments on such revisions before any changes are finalized. As part of its reconsideration, we support increased FCA collaboration with other international regulators in order to promote harmonization of regulatory requirements for firms that do business on a global basis.

* * *

We appreciate the opportunity to provide our views on these issues and would be pleased to provide any additional information. Please contact the undersigned or Karen L. Barr, General Counsel, at (202) 293-4222 with any questions regarding these matters.

Respectfully submitted,

Kathy D. Ireland
Kathy D. Ireland
Associate General Counsel

INVESTMENT ADVISER ASSOCIATION

sifma
Invested in America
asset management group

January 2, 2014

John J. Cross III
Director, Office of Municipal Securities
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear John:

Thank you to the staff of the Office of Municipal Securities for taking the time to meet with the Investment Adviser Association ("IAA")[1] on December 11, 2013, and with the IAA, the Asset Management Group ("AMG")[2] of the Securities Industry and Financial Markets Association, and outside counsel on December 30, 2013, to discuss the municipal advisor rule.

Following up on our discussions with you and as described below, we believe that time-limited relief from compliance with Rule 15Ba1-1 (the "Rule") under the Exchange Act is essential and justified for a narrow class of potential municipal advisor registrants: SEC-registered investment advisers that provide investment advice to municipal entities pursuant to an advisory agreement regarding a portfolio of investments that contains swaps and/or security-based swaps as part of ongoing portfolio management.

As we noted in our meetings with you, neither the statute, published in October 2010, nor the SEC's rule proposals, nor the extensive record developed by the Commission indicated that the Rule could potentially be applicable to traditional asset managers. Accordingly, many of our members only became aware that their portfolio management activities could potentially trigger municipal advisor registration and compliance obligations, solely as a result of including a single swap or security-based swap within the portfolios of their municipal entity clients, upon close review of the final rule. As a result, many of our members have had insufficient time to analyze the Rule, apply it to their businesses to determine their status, and potentially come into compliance by January 13, 2014, the effective date of the new definitions in the Rule.

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[1] The IAA is a not-for-profit association that represents the interests of investment adviser firms registered with the Securities and Exchange Commission. The IAA's membership consists of more than 550 advisers that collectively manage in excess of $11 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations. For more information, please visit our web site: www.investmentadviser.org.

[2] AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans and state and local pension funds.

As we discussed, we believe that the scope of the registered investment adviser exclusion as it relates to the clause referencing advice concerning municipal derivatives raises interpretive issues. In our view, the registered investment adviser exclusion should be read in light of the statutory background and context to cover investment management of portfolios that may include derivatives as "investment advice," rather than as "advice concerning municipal derivatives."

We believe that the Rule is properly interpreted to exclude registered investment advisers to the extent they engage in traditional asset management, including managing portfolios of municipal entity clients that may include swaps or security-based swaps. This interpretation would prevent duplicate regulation of the same activity by the SEC under the Advisers Act and by the MSRB under its rules (as well as the SEC under the Exchange Act) and even potential triplicate regulation for some investment advisers that are also commodity trading advisors registered with the CFTC. Duplicative regulation would be a peculiar result since the municipal advisor regime was targeted at concerns raised by unregulated entities. This interpretation excluding traditional asset management activities would also avoid the potential for "regulatory arbitrage" among the SEC, MSRB, and CFTC.

Furthermore, this interpretation avoids illogical consequences that we believe were not intended by Congress or the Commission. For example, certain SEC-registered investment advisers that include a large amount of swaps exposures in their portfolios would be exempt from registration as municipal advisors (under the registered commodity trading advisor exclusion), while those that use a de minimis amount of swaps or that use any amount of security-based swaps would be required to register as municipal advisors. It would also alleviate disruption to client portfolios and reduce substantial regulatory burdens and costs on asset managers due to differences in regulatory requirements under the Advisers Act and in both existing and future rules administered by the MSRB and the Commission under the Exchange Act.

To further inform your analysis of the important interpretive issues raised by the registered investment adviser exclusion, you requested that we provide substantial data and other information concerning the current regulatory regimes related to derivatives. We are looking forward to working with you to provide any information or assistance that you might find useful. However, since much of the information that you have requested is not readily available, it will take additional time to collect and analyze it. We also understand that the staff is actively considering numerous requests for FAQs or other interpretive guidance, and may be unable to clarify all of the important interpretive issues before the January 13, 2014 compliance date.

Therefore, we strongly urge the staff to grant narrowly-based, time-limited relief from compliance with the Rule for SEC-registered investment advisers that provide investment advice to municipal entities pursuant to an advisory agreement regarding a portfolio of investments that contains swaps and/or security-based swaps as part of ongoing portfolio management until July 1, 2014 while we work with the staff to resolve significant open interpretive matters. This date is consistent with the initial compliance date for the permanent registration and regulatory regime.

We appreciate your consideration of our comments and requests in this letter. Should you have any questions, please do not hesitate to contact Karen Barr or Laura Grossman of the IAA at 202-293-4222 or Tim Cameron of AMG at 212-313-1389 or Matt Nevins of AMG at 212-313-1176.

Sincerely,

Karen L. Barr
General Counsel

Laura L. Grossman
Assistant General Counsel

Timothy W. Cameron, Esq.
Managing Director, Asset Management Group
Securities Industry and Financial Markets Association

Matthew J. Nevins, Esq.
Managing Director and Associate General Counsel, Asset Management Group
Securities Industry and Financial Markets Association

cc: The Honorable Mary Jo White, Chairman
The Honorable Luis A. Aguilar, Commissioner
The Honorable Daniel M. Gallagher, Commissioner
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner