Remarks of David Harris
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Commodity Futures Trading Commission

Roundtable on Managed Funds

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Nasdaq Liffe Markets, LLC (NQLX) appreciates the opportunity to present its views at this roundtable discussion on managed fund issues. As a designated contract market for security futures and other futures products, NQLX has a vital interest in the health of the managed funds industry and its ability to make use of new products, strategies and markets in the most cost-effective, competitive manner. The managed funds industry clearly is a critical and growing segment of the financial markets generally, and it is one that we expect to be an important part of our security futures marketplace.

NQLX enthusiastically supports the CFTC's commitment to provide a flexible regulatory structure that maintains basic customer and market protections without unduly impeding market innovation. We especially commend the CFTC for fostering a dialogue on the topic of regulatory overlap and other regulatory issues important to the managed funds industry. Given the dynamic growth of hedge funds worldwide, the ability of this Commission and the SEC to design a coordinated regulatory framework for this market segment becomes ever more important to the competitiveness of the U.S. hedge fund market. Toward this end, a number of constructive suggestions have been offered with the goal of streamlining of regulatory

requirements applicable to hedge funds and other managed funds. NQLX is generally supportive of these proposals.

However, in the discussion today, we would like to highlight one potential impediment to market innovation and liquidity that may substantially impact the markets for security futures products. Specifically, we wish to focus upon the important issues raised by the application of commodity pool regulation to hedge funds which are prospective users of security futures products. NQLX's market research to date has identified a significant number of prospective hedge fund users of security futures products who are not currently registered with the CFTC because they do not now engage in futures transactions and do not intend to engage in futures transactions generally. However, with the launch of security futures markets, these funds are eager to make use of the expanded array of available equity-related futures products.

For the managers of such funds, whose sole involvement in the futures markets will be trading in security futures products, the burden of complying with a new regulatory structure will significantly reduce or eliminate the attractiveness of these new products.

As I have mentioned, these funds are not operated by registered commodity pool operators and are not otherwise subject to CFTC regulation. While such funds are offered in compliance with the private offering exemptions of the federal securities laws, in many cases they will not qualify for the CFTC's Rule 4.7 exemption. Because they did not contemplate trading in futures, they were not offered pursuant to the Rule 4.7 exemption, and their investor base may well include persons who do not satisfy Qualified Eligible Person (QEP) requirements. Absent exemption, in order to transact in security futures products, the operators of these funds would be required to register as commodity pool operators and to establish a disclosure,

reporting and recordkeeping compliance program tailored specifically to CFTC requirements. The attendant costs are by no means limited to the registration burdens falling upon the commodity pool operator, its sales persons and supervisory personnel. Extending CFTC requirements to funds that do not qualify for the CFTC's Rule 4.7 exemption would require that a CFTC Part 4 disclosure document, which as you know, differs greatly from a conventional private offering memorandum, be produced solely for the purpose of complying with CFTC requirements arising from security futures transactions.

It is not difficult to deduce that the cost-benefit assessment of security futures products for the fund managers I have described will be significantly weighted against security futures products by the regulatory costs to be incurred in complying with CFTC requirements. Needless to say, these same funds could transact in functionally related products -- for example, options on securities and equity swaps -- without incurring any of these regulatory costs. The barriers created to hedge fund participation in security futures products in this situation do not, in our view, reflect a considered and rational public policy. However, we believe that the CFTC has the authority and the commitment to market innovation needed to address this type of regulatory anomaly and avoid unnecessarily constraining access to security futures markets.

Security futures products, as this Commission well knows, will be offered under a regulatory structure that is designed to interlace SEC and CFTC regulation in a manner that preserves critical customer and market safeguards but avoids needless duplication. In designing this structure, Congress took pains to prevent regulatory arbitrage from determining the success or failure of any product. The Commodity Futures Modernization Act (CFMA) clearly reflects Congress's view that security futures and securities options should not be handicapped against

each other by disparate regulatory standards. However, absent a new exemption or other relief from the CFTC, hedge fund operators not currently subject to CFTC regulation would find that the use of security options would impose lower regulatory costs than security futures products.

Clearly, the CFTC has the authority to address this situation. The CEA gives the CFTC express authority to exclude from the definition of commodity pool operator "persons not with the intent of the definition of the term as the Commission may specify by rule, regulation, or order." In the past, the Commission has exercised this authority to carve out of its regulatory program a variety of entities whose activities were found to be adequately addressed by another regulator. In the spirit of the CFMA's recognition of the dual character of security futures as both securities and futures, we submit that funds whose futures activities are limited solely to security futures would be an appropriate context for the exercise of the CFTC's authority to provide relief from CPO regulation. While SEC regulation is not identical to CFTC regulation, the federal securities laws will apply to the security futures component of these funds' activities to the same extent as their other securities activities, given the unique regulatory status of security futures products. The security futures activities of these funds are likely to be secondary and incidental to their core equity investment activity, a situation which the CFTC has in the past deemed appropriate for regulatory relief. (See, e.g., Rule 4.12(b), Rule 4.14(a)(8)). This is not a situation in which a fund is seeking to diminish its regulatory duties, but rather, one in which a fund would be permitted to make use of a new, dually regulated product without taking on a new set of regulatory responsibilities solely for that product.

NQLX urges the CFTC to create a full regulatory exemption for privately held funds that will confine their futures-related activity to security futures products. Such an exemption would

serve market innovation without compromising the public interest. To the extent that the CFTC were to create such an exemption, it could assure access to needed market data by means of an appropriate information-sharing arrangement with the SEC or a special call procedure. NQLX stands ready to assist the CFTC in constructing a reasonable and prudent exemption of this nature.

Thank you again for the opportunity to present our views on this important subject.