From: Han, Jennifer <jennifer@managedfunds.org>
Sent: Wednesday, September 22, 2010 11:36 AM
To: dfarulemakings <dfarulemakings@CFTC.gov>
Subject: Comments on Initiatives Under the Dodd-Frank Act
Attach: MFA CFTC Letter.9.22.10.pdf

Dear Mr. Stawick,

Managed Funds Association appreciates the opportunity to submit the attached comments on the CFTC's initiatives under the Dodd-Frank Act.

Please feel free to contact me if you have questions or comments.
Thanks.

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

September 22, 2010

Via Electronic Mail: dfarulemakings@cftc.gov

David A. Stawick
Secretary
U.S. Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Re: MFA Comments on CFTC Regulatory Initiatives Under the Dodd-Frank Act

Dear Mr. Stawick:

Managed Funds Association ("MFA")[1] appreciates the opportunity to comment on the Commodity Futures Trading Commission's (the "CFTC" or the "Commission") Comment Page for CFTC Initiatives Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). MFA applauds this initiative for offering interested parties an important opportunity to have input into this unprecedented rulemaking process, even before the Commission and the Securities and Exchange Commission (the "SEC") publish many specific releases for comment. We recognize that the Dodd-Frank Act reframes the overall regulatory landscape, but that the CFTC and SEC, among other agencies, will be responsible for implementing key details surrounding many of the crucial provisions. We also recognize that many of these areas are complex and new to regulatory oversight, and we pledge our support in helping the agencies address the range of issues in which our members have expertise. Further, we appreciate that the Commission and the SEC continue to coordinate on regulatory initiatives, toward the shared goal of enhanced oversight that promotes efficiency and leverages cross-agency experience.

MFA endeavored to be an active and constructive participant in the discussions leading up to the passage of the Dodd-Frank Act and intends to be similarly engaged in the rulemaking process. We were supportive of the overall goals of the legislation and are committed to seeing them faithfully implemented. As part of our legislative engagement, for example, we testified nine times before Congress regarding financial

[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $1.5 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

regulatory reform.[2] As longstanding market participants, we strongly supported the strengthening of our nation's financial regulatory system. The devastation of the financial crisis was felt by all, including hedge funds and, in turn, by institutional investors in our funds. Hedge funds were customers and counterparties of the large banks, and the harm that they encountered, along with investors of every stripe, underscores the need for reform. In the OTC derivatives market, for example, we supported the establishment of mandatory clearing requirements for eligible swaps to mitigate counterparty, systemic, and operational risk and to promote transparency.

In keeping with the spirit of the Commission's initiative, we thought it appropriate to offer some general comments on the provisions of the Dodd-Frank Act that would most directly affect our members. We have not limited our comments to only those items included on the Commission's Comment Page, but have included additional issues of significance to our industry. We also intend to comment on specific rule proposals as they are issued.

As the Commission considers the regulatory framework, we believe that it is important to be clear about the size, scope and activities of the hedge fund industry in the context of other financial market participants. Although the hedge fund industry is important to capital markets and the financial system, it is relatively small in size and scope when considered in the context of the wider landscape. For example, the hedge fund industry is significantly smaller than both the global mutual fund industry and the U.S. banking industry. The global mutual fund industry managed $23.02 trillion in assets, as of March 31, 2010.[3] The top 50 U.S. bank holding companies alone had $14.4 trillion in assets, as of June 30, 2010.[4] By comparison, the global hedge fund industry had approximately $1.53 trillion in assets under management, as of July 2010, with the entire industry smaller than each of the three largest bank holding companies individually.[5]

Similarly, though private investment funds are often characterized as being highly leveraged financial institutions, the industry is, and has been, significantly less leveraged than other financial market participants. According to a recent study by academics at Columbia University, the leverage ratio of investment banks during the period from December 2004 to October 2009 was 14.2, with a peak of 69.5 for investment banks in 2009, and the leverage ratio of the entire financial sector during that period was 9.4.[6] By

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[2] Copies of MFA's testimonies are available at www.managedfunds.org.

[3] Source: Investment Company Institute, available at: http://www.ici.org/research/stats/worldwide/ww_03_10

[4] Source: Federal Financial Institutions Examination Council, available at: http://www.ffiec.gov/nicpubweb/nicweb/Top50Form.aspx.

[5] Available at: http://www.finalternatives.com/node/13723

[6] Hedge Fund Leverage, available at: http://www2.gsb.columbia.edu/faculty/aang/papers/HFleverage.pdf

comparison, this study found that the leverage ratio for the hedge fund industry was 1.5 as of October 2009, with an average ratio of 2.1 from December 2004 to October 2009, with a high of 2.6. The findings of this study with respect to the leverage ratio of the hedge fund industry are consistent with other studies, which report leverage ratios below 3.0 for an extended period of time.[7]

As the Commission develops an OTC derivatives regulatory framework, we encourage it to consider the limited size and leverage of private investment funds compared to other financial market participants. In that regard, we support efforts by the Commission to gather information about the private investment fund industry and other financial market participants. We believe that it is important for regulators to have access to market data so that they are able to make decisions based on complete information about markets and market participants.

I. General Comments

MFA supports a renewed regulatory framework that will minimize systemic risk, strengthen investor protection, and promote market discipline and integrity. Recognizing the deficiencies that contributed to the financial crisis and taking focused steps to remedy them in a manner that promotes clear and consistent rules is critical to restoring investor confidence and market stability. Our industry is comprised of investors who rely on markets to be fair, open, and free from manipulation in order to conduct their businesses. We are subject to the same extensive rules and regulations under the federal securities laws and the Commodity Exchange Act as other investors and market participants and are longtime advocates of clear guidelines and strong enforcement.

Our members actively deploy risk capital in markets throughout the world and invest heavily in proprietary strategies to identify new opportunities. We recognize the

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[7] *See*, BofA Merrill Lynch study, which finds the leverage ratio for the industry was 1.16 as of July, 2010 http://www.reuters.com/article/idUSTRE67G28220100817; *see also*, FSA study, Assessing possible sources of systemic risk from hedge funds, July 2010 (finding a leverage ratio of 272%, as of April, 2010), available at: http://www.fsa.gov.uk/pubs/other/hedge_funds.pdf, and The Turner Review, A regulatory response to the global banking crisis, March 2009 (finding that the leverage ratio of the hedge fund industry since 2000 has been two- or three-to one), available at: http://www.fsa.gov.uk/pubs/other/turner_review.pdf.

The above studies use different formulas for calculating leverage ratios, which explains the slight differences in leverage ratios determined by each study. Our purpose in this letter is not to endorse any particular formula, but to demonstrate that the leverage ratios for the hedge fund industry are significantly less than the ratios for many other types of financial institutions. MFA is preparing a comment letter in response to the SEC's and CFTC's Advance Joint Notice on Definitions Contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, in which we provide thoughts on how the agencies should define "highly leveraged" for purposes of the "major swap participant" definition.

need for regulators to have access to information about our activities in order to have a comprehensive view of the markets and effectively oversee the financial system. At the same time, we note the importance of maintaining utmost confidentiality and conducting inquiries in a judicious manner so as to ensure privacy and manage the costs of compliance. We also note the significance of international coordination in ensuring consistent regulation across borders and promoting competition and innovation in all markets.

II. Title VII

We strongly support the goals of OTC derivatives regulation to enhance transparency and reduce systemic risk. We also recognize that these instruments play such a crucial role in our financial markets by allowing companies to effectively manage their financial and business risks, and we therefore, want to ensure that unintended consequences of the regulations do not reduce or restrict the availability of customized risk management tools. Thus, we urge the Commission to gather substantial data on this new area of oversight and tailor its rules and regulations to address identified risks and the intended objectives of the Dodd-Frank Act. In addition, we request that the Commission adopt appropriate grandfathering provisions to ensure that existing derivatives transactions are not adversely affected by rulemakings resulting from the Dodd-Frank Act.

In this letter, we are providing our general thoughts on the various issues from Title VII of the Dodd-Frank Act that are of greatest significance to us. We also fully intend to comment on the specific rule proposals related to Title VII that are relevant to MFA's constituencies, as the Commission issues them.

A. Definition of "Swap Dealer"

Section 721 of the Dodd-Frank Act defines "Swap Dealer" (in relevant part) as a person who: (i) holds themself [*sic*] out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing it to be commonly known in the trade as a dealer or market maker in swaps.[8]

We are concerned that because of the breadth of this definition, it may inadvertently capture regulated, non-bank customers. Specifically, prong (iii) of the definition, which relates to "regularly entering into swaps", would capture parties that would traditionally be thought of as investors or hedgers, as opposed to true futures commission merchants ("FCMs"), dealers or market-makers. We note that "dealer" is defined under the Securities Exchange Act of 1934 ("Exchange Act") with similar language as prong (iii) of the Swap Dealer definition. The SEC has issued guidance on the definition of dealer, which has a longstanding role in market parlance and practice,

[8] Section 721 amends Section 1(a) of the Commodity Exchange Act, as amended (the "CEA"), to add new subsection (49).

and which specifically excludes those market participants who are not "in the business" of buying and selling securities as well as those who buy and sell for their own account.[9] We respectfully suggest that the Commission should consider this established standard as it further defines Swap Dealer.[10]

B. Definition of "Major Swap Participant"

Section 721 of the Dodd-Frank Act defines "Major Swap Participant" ("MSP"), in large part, as a non-Swap Dealer: (1) who maintains a substantial position in swaps; (2) whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or (3) is a financial entity that is highly leveraged relative to the amount of capital that it holds and maintains a substantial position in outstanding swaps.[11]

MFA believes Congress's intent in creating an MSP designation was to focus regulation on systemically important, non-dealer market participants whose swap positions may adversely affect market stability. One example of such an entity was AIG, which was an exception to normal market practice. Unlike other customers, AIG, given its market presence, enormous size, and AAA-rating was not required to post initial margin on its trades to its dealer counterparties and was only required to post variation margin once rating agencies belatedly downgraded AIG's credit rating. Thus, when AIG was on the brink of default, it exposed its swap counterparties to massive losses and put the broader financial system at risk. In contrast, dealers engage in extensive due diligence with respect to private investment funds before entering into swaps with them. Dealers also insist that private investment funds collateralize their trades by posting initial and variation margin, which protects the dealer counterparty and the financial markets from risk in the event of the fund's default. We strongly support the need for enhanced market standards and consistency to prevent anomalous and dangerous practices, such as AIG's, and which mitigate the excessive build-up of counterparty and systemic risk. In addition, we note that the Dodd-Frank Act will already require our membership to report extensively on its market activities as registered advisers, whether or not private investment funds are designated as MSPs.

A crucial component of the MSP categorization is the definition of "substantial position", which Congress instructed the Commission to define in a manner that safeguards against systemic risk. We are supportive of this approach and believe that, in determining whether a market participant has a "substantial position" in swaps, we

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[9] Section 3(a)(5) of the Exchange Act provides the following "dealer" definition: "[t]he term 'dealer' means any person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise" and excludes "a person that buys or sells securities for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business."

[10] We discuss the SEC's longstanding dealer definition in further detail in our comments to the CFTC and SEC Advance Joint Notice on OTC derivatives definitions.

[11] Section 721 amends Section 1(a) of the CEA to add new subsection (33).

believe the Commission should consider such market participant's overall position in swaps, accounting for offsetting positions, including cleared contracts and securities that mitigate risk. We also support Congress's direction to the Commission that in defining "substantial position" the Commission must take into account "the person's relative position in uncleared as opposed to cleared swaps and may take into consideration the value and quality of collateral held against counterparty exposures."[12] Such guidance will help capture the actual risk to counterparties and the broader system if the market participant failed, and would recognize the market-disciplining activities of central clearing and increased bilateral reserves as contemplated by the Dodd-Frank Act. Indeed, the Dodd-Frank Act requires central clearing and collateralization because of their risk mitigating effects and because they will cushion counterparties and the financial system in the event of a default. A market participant that makes use of these practices to safeguard its swaps should not fall within the MSP definition.[13]

We would be happy to discuss the above points in greater detail with the Commission in their effort to develop specific regulatory language.

C. MSP Registration

Section 731 of the Dodd-Frank Act gives the Commission broad discretion to set the registration requirements for MSPs. As mentioned herein, whether private investment funds fall within the MSP definition will depend in large part on the definition of "substantial position". Given that our activities are dynamic, the value and volume of the positions in our swaps portfolios may turnover, increase or decrease on a frequent basis. Accordingly, unlike other market participants, our members have the potential to routinely fall in and out of the MSP category. To that end, we request that in crafting rules surrounding registration, the Commission have regard for dynamic business models and build flexibility into the construct to ensure that regular deregistration and re-registration are not required.

D. Registration as a Futures Commission Merchant

With respect to cleared and uncleared swaps, Section 724 of the Dodd-Frank Act, makes it unlawful for a person to accept any money, securities, or property as margin from a swaps customer, unless the person has registered as an FCM. As customers, we strongly support the protection of the positions and collateral of swap customers. However, we are concerned that this registration requirement does not distinguish between the receipt of initial margin—which is a one-way payment made by a swap

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[12] *See* Section 721. Section 1(a)(33)(B) of the CEA defines "substantial position," which is relevant to the determining who is an MSP. In considering the value and quality of collateral held against the counterparty exposure, we believe it is important for the Commission to consider the category or type of swap as different types of swaps carry different risk profiles.

[13] *See* statement from Senator Lincoln in a colloquy between Senator Hagan and Senator Lincoln (Cong. Record, July 15, 2010) on determining whether an entity has a "substantial position": "Entities that fully collateralize swap positions on a bilateral basis with their counterparties, thereby reducing their potential to adversely affect market stability, should be viewed differently from those that do not."

customer to a swap dealer at the outset of a trade—and variation margin that both swap counterparties may exchange with each other to reflect a mark-to-market change throughout the life of a trade.[14]

In addition, with respect to both cleared and uncleared commodity-based swaps, if we and other swap customers could not collect variation margin without being required to register as FCMs, two significant, negative consequences would result. First, counterparty, systemic and liquidity risks would greatly increase because customers would have an incentive to elect not to secure their exposure through the receipt of variation margin in order to avoid becoming FCMs. Second, customers would likely experience significant liquidity risks to the extent that they would be required to pay out cash for variation margin on unprofitable transactions, but would be unable to collect variation margin on transactions that are in their favor.

We believe that for both cleared and uncleared commodity-based swaps, Congress did not intend to subject swap customers to the rigors of FCM registration and regulation. Moreover, we believe that Congress did not intend to define FCMs to include a person who accepts variation margin. Accordingly, we believe it would be prudent for the Commission to employ its authority under Section 721 of the Dodd-Frank Bill by further defining the term "margin" for this purpose as initial margin.

E. MSPs: Capital and Margin Requirements

Section 731 of the Dodd-Frank Act provides for the registration and regulation of MSPs and directs the Commission to impose capital and margin requirements on MSPs. Capital requirements are inconsistent with the business structures and risk profiles of certain non-bank entities that are not already subject to regulatory capital requirements, and imposing capital requirements on such entities could have significant, unintended consequences, including by effectively precluding them from participating in the market. Thus, in establishing capital requirements for non-bank MSPs, we believe it is important for the Commission to consider the different business structures and risk profiles of the various participants and tailor requirements appropriately.

As the Commission is aware, capital requirements are an established feature of banking regulation designed to protect against unexpected losses without adversely affecting the interests of creditors (such as depositors, policyholders, or the government). Banks set aside capital as a percentage of their overall risk exposure, with permanent Tier 1 capital as the core measure of their financial strength. In contrast, many non-bank financial entities, such as private investment funds, do not have such creditors, only investors, and do not have permanent Tier 1 capital, as these entities serve a different role and purpose in the markets. Specifically, investment advisers manage assets of private investment funds on behalf of such fund's investors, which frequently include pension plans and endowments. The assets are not permanent but rather belong to the investors,

[14] We are also concerned that this requirement applies to both cleared and uncleared swaps in contrast to the registration requirements for security-based swaps, which only apply to cleared swaps.

which have the right to redeem them subject to the terms of their contractual agreements. In this respect, all of the fund's investments, including swaps, belong to the investors. The funds, in turn, are mandated by their investors[15] to make investments with their capital and the investors assume the risks associated with that arrangement. Ultimately, any losses incurred by the funds are ultimately borne by the investors themselves, with the fund's counterparties protected by the posted collateral.

The posting of collateral by private investment funds serves the same function that capital does for banks and other similarly regulated financial entities (*i.e.*, protecting the counterparty and financial system against such entities' default). In addition, the imposition of capital requirements on non-bank MSPs would greatly increase the cost of doing business for these entities and could result in other attendant consequences. Accordingly, we believe that in setting capital requirements for non-bank MSPs, the Commission should count collateral posted by such non-bank MSPs towards any such non-bank MSP capital requirements.

F. Mandatory Clearing and Exchange Trading

Section 723 of the Dodd-Frank Act requires market participants to clear any swap that a clearing agency will accept for clearing and that the Commission requires to be cleared. In addition, Section 723 of the Dodd-Frank Act requires swap counterparties to execute all cleared swaps on an exchange or swap execution facility ("SEF") unless no exchange or SEF makes the swap available for trading.

MFA supports a regulatory framework that encourages central clearing of OTC derivatives. We believe that central clearing will play an essential role in reducing systemic, operational and counterparty risk, as it does in the equity and futures markets, and that the imposition of clearing and exchange trading to the extent practicable will offer increased regulatory and market efficiencies and greater market transparency and competition. Although we expect a bilateral market to remain for market participants to customize their business and risk management needs, we believe that mandatory clearing and exchange trading to the extent practicable will offer increased regulatory and market efficiencies, greater market transparency and competition.

As customers, we recognize that the success of swap clearing and exchange trading will depend on the structure, governance and financial soundness of central counterparties ("CCPs"), SEFs and exchanges. Accordingly, we emphasize the need for CCPs, SEFs and exchanges, wherever applicable, to have transparent and replicable risk models and to enable fair and open access in a manner that incentivizes competition and reduces barriers to entry. In addition, from a customer protection perspective, we believe it is important to have customer representation on the governance and risk committees of CCPs because given the critical decisions such committees will make, they will benefit from the perspective of such significant and longstanding market participants. Finally, we request that the Commission implement rigorous standards for the approval of CCPs,

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[15] Typically, the advisor's employees are significant investors in their own funds.

SEFs and exchanges and require that such entities have appropriately robust internal policies and processes to mitigate their risk to the financial system.

G. Segregation of Collateral

For cleared swaps, Section 724 of the Dodd-Frank Act requires each Swap Dealer or MSP to segregate customer margin from its own proprietary assets and prohibits the Swap Dealer or MSP from using such customer assets to margin, secure or guarantee any of its trades or contracts with third parties. For uncleared swaps, Section 724 of the Dodd-Frank Act requires the Swap Dealer or MSP to notify its swap counterparty that the counterparty has the right to require segregation of its margin in an account with an independent third-party custodian.

With respect to cleared swaps, MFA strongly supports the segregation of initial margin, including in a segregated account or other form permitted under applicable regulation, from the proprietary assets of an FCM or Swap Dealer as a critical component to the effective functioning of the mandatory clearing regime. With respect to uncleared swaps, we support the Dodd-Frank Act's requirement that a Swap Dealer offer its customer the option to segregate initial margin in a custodial account for the benefit of the customer, separate from the assets and other property of the Swap Dealer. Moreover, we believe that the Dodd-Frank Act gives the Commission the authority to establish rules requiring FCMs and Swap Dealers to individually segregate customer assets for both cleared and uncleared swaps, rather than segregate assets of all customers in an omnibus account. Accordingly, to the extent that an offering of solely individual segregation for cleared and uncleared swaps is practicable from a cost and risk management perspective, MFA supports the Commission implementing rules allowing the customer to choose between an omnibus account and an individual account.

H. Transaction Reporting

Section 729 of the Dodd-Frank Act requires transaction reporting of uncleared swaps. We fully support the need for the Commission to receive timely transaction reporting in order to provide a clear picture and effective oversight of the financial markets. We support the transaction reporting obligations of the Dodd-Frank Act, which require dealers to report when they are a counterparty to a transaction.

In particular, we believe that the most efficient method for the Commission to accomplish the goal of timely transaction reporting is by requiring dealers to report, since dealers already have established robust transaction reporting systems and have customarily provided transaction confirmations or reports to customers. Customers of dealers, on the other hand, generally do not have reporting systems in place and requiring them to establish such systems would be costly and inefficient when there is a dealer alternative.

We would urge the Commission, however, to take into consideration the impact that rules and regulations on public reporting of transactions could have on the market liquidity of swaps.

I. Position Limits

Section 737 of the Dodd-Frank Act requires the CFTC to establish limits on the amount of positions, as appropriate, that may be held by any person with respect to contracts traded on a designated contract market; and to set aggregate position limits based upon the same underlying commodity, including certain OTC derivatives contracts and contracts traded on a foreign board of trade. We believe the Dodd-Frank Act provides the CFTC with flexibility in implementing position limits by granting the CFTC general exemptive authority. In MFA's view, the CFTC should use such authority as necessary in contemplating whether position limits are appropriate for each market; and to ensure that U.S. futures and swap markets are deep and liquid, allow market participants' to transfer risk and hedge against future prices, and preserve the need for market integrity.

In promulgating position limits regulation, we believe it is critical for the CFTC to first gain a comprehensive understanding of the size of the physical markets, the futures markets and the OTC derivatives markets, before imposing position limits. Overly restrictive position limits could severely impact market liquidity and the ability of market participants to manage business risk. Accordingly, we urge the CFTC to consider data on the full size of the physical, futures and OTC derivatives markets before imposing position limits. In addition, we believe it is important that in setting position limits the Commission continue to allow for disaggregation of independent account controllers based upon independence of control. We are concerned that the absence of independent account controller relief from aggregation would reduce market liquidity for *bona fide* hedgers and adversely impact the price discovery function of U.S. futures markets.

J. Definition of "Swap Execution Facility"

Section 721(a)(21) of the Dodd-Frank Act defines a "swap execution facility" (a "SEF") as "a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that—(A) facilitates the execution of swaps between persons; and (B) is not a designated contract market." However, in recent statements, regulators have indicated that they may further narrow this definition by requiring that to qualify as a SEF "a company must offer a 'many-to-many' platform, or a platform that lets multiple players transact on swap deals."[16]

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[16] Sarah N. Lynch, "CFTC's Gensler: Swap Trading Venues Will Face Changes Under New Rules", Dow Jones Newswires, Sept. 9, 2010.

MFA believes that each swap trading platform needs to be appropriate for the product type it will execute, as the characteristics and corresponding trading needs vary. In addition, we believe that permitting the broadest range of swap trading platforms (subject to the requirements under the Dodd-Frank Act) would benefit investors, promote market-based competition among providers, and enable greater transparency over time and across a variety of products. In promulgating rules surrounding this definition, the Commission should ensure that it does not construe the scope of the SEF definition too narrowly. Rather, the Commission should preserve flexibility and opportunity for variety and organic development among trading platforms to the benefit of all market participants and consistent with the approach in other markets.

III. Other Relevant Regulatory Issues

A. Investment Advisers Act Exemption for Registered Commodity Trading Advisors ("CTAs")

Section 403 of the Dodd-Frank Act retains the exemption for CTAs whose business does not consist primarily of acting as an investment adviser from registering with the SEC if they are registered with the Commission. Section 4(m)(3) of the CEA provides an analogous exemption from registration as a CTA for a CTA that is registered with the SEC as investment adviser and whose business does not consist primarily of acting as a CTA.[17] The Dodd-Frank Act does not amend this section, but rather adds a new provision in Section 403, which provides that an adviser to a private investment fund that is also a registered CTA is exempt from registration with the SEC, unless the business of the adviser should become predominantly the provision of securities-related advice.

MFA encourages the Commission and the SEC to adopt guidance clarifying the criteria relevant to determining whether a CTA or an investment adviser that is registered with one of the agencies can rely on the relevant exemption from registration with the other agency, respectively. In this regard, in September of 2009, MFA filed a comment letter with the Commission and the SEC recommending that they consider the factors addressed in the *Peavey Commodity Futures Fund* no-action letter.[18] We continue to believe that the factors addressed in the letter provide an appropriate framework for determining the primary (or predominant) business of a CTA or an investment adviser.

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[17] We note that CFTC regulations also provide for other exemptions from registration as a CTA or as a commodity pool operator.

[18] *See* Peavey Commodity Futures Fund, SEC No-Action Letter (pub. avail. June 2, 1983), 1983 SEC No-Act. LEXIS 2576 (determining the primary engagement of a fund for purposes of the Investment Company Act of 1940, as amended). *See also,* Tonopah Mining Co. of Nevada, 26 S.E.C. 426 (1947) (adopting a five factor analysis for determining an issuer's primary business for purposes of assessing the issuer's status under the Investment Company Act of 1940, as amended) (the "1940 Act").

A copy of MFA's comment letter is available at http://www.managedfunds.org/downloads/MFA%20response%20to%20SEC.CFTC.9.25.09.pdf.

With respect to registration, we also note that there are market participants who are or may become registered with both agencies as a CTA and/or commodity pool operator and an investment adviser (and quite possibly one day as an MSP and major security-based swap participant). MFA encourages the Commission and the SEC, in addition to jointly promulgating rules to establish records and reports of private funds pursuant to section 406 of the Dodd-Frank Act, to consider the registration requirements of private funds and their advisors under the CEA and the federal securities laws to simplify the registration process and to avoid potentially inconsistent regulatory requirements.

B. Determination of Systemically Important Financial Companies

Section 112 of the Dodd-Frank Act provides the newly-created Financial Stability Oversight Council ("FSOC") with the authority to designate non-bank financial companies as systemically important and permits the FSOC, acting through the Office of Financial Research, to collect reports from such non-bank financial companies for the purpose of determining whether the company poses a threat to U.S. financial stability. The Commission will be a member of the FSOC and, as a primary regulator for private investment advisor/funds, will have a significant role to play in determining if any such adviser or any private investment funds that it manages should be deemed to be systemically important.

We strongly support the goals of the Dodd-Frank Act in establishing the FSOC to address potential systemic risks before they arise and we support enhanced regulation of systemically relevant, non-bank financial companies, such as those entities that pose "AIG-like" risks to their counterparties or the marketplace. MFA also strongly supports efforts by regulators to gather data from different types of market participants, including investment advisers and the funds they manage. We believe that regulators should have access to quantitative data to help them determine which bank and non-bank financial companies are systemically important based on full and complete information.

Section 113 of the Dodd-Frank Act sets out a list of factors to be considered by the FSOC when determining whether a financial institution should be deemed systemically significant. We believe that as these factors are developed into regulation the following items may be appropriate to consider:

> (1) whether assets under management are (a) owned funds, as in the case of a bank or insurance company, where all of the risk and residual value of investment portfolios go to managers and their stockholders, or (b) managed funds, as in the case of mutual and hedge funds, where the risk and residual value of investment portfolios go to outside investors and may or may not be shared with the fund adviser;
>
> (2) the size of individual and aggregate investment fund portfolios managed by an investment adviser, in the context of the specific capital market segments in which such funds are active;

(3) the degree of investment funds' portfolio leverage in the context of their asset mixes, including the extent to which their borrowings and other liabilities are secured or unsecured;

(4) the sources of investment fund portfolio leverage, whether they are capital-markets based and require relatively frequent roll-over (*e.g.*, commercial paper) or whether they are committed to the funds under medium- or long-term contracts;

(5) the "stickiness" of investment funds' equity capital underlying that leverage, *i.e.*, whether managers can count on investors being locked-up sufficiently to avoid forced unwind of portfolios during financial stress;

(6) the stability of investment fund portfolios, *i.e.*, the extent to which they are subject to a level of volatility likely to require a forced unwind, given the degree of leverage, sources of leverage, and equity capital "stickiness";

(7) whether individual investment fund portfolios are long, short or market neutral and their resulting correlation to specific capital market segments, which could indicate such portfolios' vulnerability when the respective market segments come under financial stress;

(8) the degree of a firm's interconnectedness to major financial institutions, such as whether the firm in question is a top counterparty to such institutions, measured by such institutions' unsecured credit exposure to the firm in question, indicating the overall vulnerability of other major financial institutions if the firm in question were to fail;

(9) the extent to which the persons managing a firm and its investment funds have substantial stakes in the firm's ownership and/or such investment funds' equity capital, which incentivizes such persons not to take inappropriate investment or operational risks that could contribute to the failure of such firm; and

(10) whether an investment fund or other financial institution has an implicit or explicit government guarantee (*e.g.*, FDIC deposit insurance and debt guarantees), access to government-funded capital (*e.g.*, TARP) or other access to government assistance (*e.g.*, access to the Federal Reserve's discount window) any of which would pose losses to taxpayers from the firm's failure.

The legislative history of the Dodd-Frank Act indicates that Congressional intent was that the FSOC designate as systemically important and regulate only those financial institutions that were previously considered "too big to fail," *i.e.*, those companies that if they failed would threaten U.S. financial stability. As we discussed above, the hedge fund industry is of limited size and leverage relative to other market participants such as mutual funds, bank holding companies and investment banks. Because of the limited size and relatively low leverage of hedge funds, no hedge fund failures during the recent

financial crisis had a meaningful impact U.S. financial stability, which we believe demonstrates that it is unlikely that any family of private investment funds is systemically significant. We recognize that the FSOC has an ongoing responsibility to monitor and assess the systemic risk of market participants and we look forward to continuing the dialogue on this subject with the CFTC and other regulatory members of FSOC.

B. Disparate Treatment of Creditors in Resolution Framework

MFA supports a resolution authority that unwinds failing firms that pose a threat to the system. Because Title II of the Dodd-Frank Act establishes a new resolution framework that intentionally creates new rules distinct from existing rules and practices under bankruptcy law, investors face a significant amount of uncertainty with respect to the implementation of this new framework. We believe that it is important for regulators to create clear, objective rules regarding the implementation of the resolution framework to reduce the current uncertainty investors and counterparties face.[19]

We are particularly concerned with those provisions in Title II of the Dodd-Frank Act, which enable the FDIC to treat similarly situated creditors (*i.e.*, creditors of the same class) differently. We believe these provisions, if interpreted too broadly, will create enormous uncertainty for investors in the debt of these institutions and for other creditors. This uncertainty – *e.g.*, that the FDIC could potentially pay one bondholder a higher amount for its bonds versus another bondholder holding equivalent bonds – will inhibit investors from staying invested in, providing capital to, or otherwise doing business with, financially weak or weakening firms, at the very time such firms need capital most. Moreover, the potential for politically-based decisions, in which the FDIC and/or other government officials pick "winners" and "losers" in connection with the distribution of assets during the liquidation of a seized firm, will chill investor interest and raise costs. The follow-on effects on the market could be profound, with vulnerable firms failing more rapidly and contagion spreading to other financial firms of questionable health; in effect producing the opposite of the intended goals of reduced and contained risk. In light of the adverse effects these provisions could have for investors and for U.S. capital markets, it is imperative that the Commission, as a member of the FSOC, actively engage the FDIC as that agency promulgates rules on how to implement this new statutory authority and work with the FDIC to ensure that those rules treat similarly situated investors equitably.

C. CFTC Data Collection

MFA is supportive of the Commission's need for greater transparency about the business activities of market participants for purposes of analyzing the risk that such

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[19] We note the relative ease in which the futures and options contracts held by Lehman Brothers on behalf of its customers were safely transferred out of the company within a single week of the bankruptcy filing, and believe regulators should consider aspects of the customer protections afforded futures customers and the futures insolvency regime. *See* Will Acworth, The Lessons of Lehman, Reassessing Customer Protections, Futures Industry Magazine, January/February 2009, *available at:* http://www.futuresindustry.org/fi-magazine-home.asp?a=1297.

participants pose to the financial system. In connection with efforts by the Commission to collect data from private investment funds, their advisors or other market participants, the Commission may receive data from and about private investment funds and their investors that is proprietary and/or confidential. MFA's members expend significant time and resources to employ safeguards to preserve their trade secrets and protect the proprietary and/or confidential information of their investors and their private investments funds. While we respect and support the regulators' legitimate needs to collect such information, we are concerned about the harmful effects to investors and our members if such information were disclosed, reverse engineered or otherwise misappropriated. As a result, it is essential that the Commission protect any such information that it receives in response to such surveys to the fullest extent permitted by law.

In addition, as the Commission knows, various international regulators have requested that advisors complete surveys aimed at gathering information to analyze systemic risk. We also believe that the SECC and other U.S. regulators are considering engaging in similar data requests. As part of our support of the regulatory and informational needs underlying such surveys, we have willingly participated in these efforts and had provided the requested data in response to regulator requests domestically and internationally. However, we are concerned that each survey requires us to expend significant time and resources to respond to these requests and that the scope and type of information that different regulators are requesting is not uniform and does not reflect the ways in which we currently keep information. As a result, in the event that the Commission decides to engage in a similar survey or data request, we emphasize that it is important that the Commission coordinate with other regulators to ensure that to the extent possible, these surveys are uniform, comparable and consistent; that regulators provide respondents a sufficiently reasonable period of time to comply; and that regulators take into account our current recordkeeping systems and methodologies, so that the information provided to the Commission is consistent and useful.

IV. Conclusion

MFA appreciates the opportunity to comment on the Commission's Comment Page for CFTC Initiatives Under the Dodd-Frank Act. As the Commission works to implement the numerous provisions of the Dodd-Frank Act, we intend to offer what we hope will be seen as pragmatic and constructive comments on the Commission's implementation.

(Continued…)

If you have any questions regarding any of these comments, or if we can provide further information with respect to these or other regulatory issues, please do not hesitate to contact Stuart J. Kaswell or me at (202) 367-1140.

Respectfully submitted,

/s/ Richard H. Baker

Richard H. Baker
President and CEO

CC: The Honorable Gary Gensler
The Honorable Michael Dunn
The Honorable Bart Chilton
The Honorable Jill E. Sommers
The Honorable Scott D. O'Malia
Dan Berkovitz, General Counsel
Richard Shilts, Acting Director, Division of Market Oversight
Ananda Radhakrishnan, Director, Division of Clearing and Intermediary Oversight