INVESTMENT COMPANY INSTITUTE

COMMODITY FUTURES TRADING COMMISSION RECEIVED

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COMMENT

COMMODITY FUTURES TRADING COMMISSION RECEIVED FOR PUBLIC RECORD

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Ms. Jean A. Webb
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Account Identification for
Eligible Bunched Orders

Dear Ms. Webb:

The Investment Company Institute[1] appreciates the opportunity to comment upon the revisions recently proposed by the Commodity Futures Trading Commission to Rule 1.35(a-1) under the Commodity Exchange Act (the "Act"), which would permit the bunching of account orders under specified conditions. While the Institute had expressed concerns with the previously published version of this proposal,[2] we are pleased that, as revised and currently proposed, several of our concerns have been alleviated. As discussed below, we continue to be concerned about the proposed restriction on proprietary interests in a participating account. In addition, we suggest that the Commission clarify certain aspects of the proposal. Subject to the comments noted below, the Institute supports the adoption of the Commission's current proposal.

The proposed amendments would relax the current prohibition against bunching and permit the bunching of eligible futures or futures options orders placed by an eligible account manager on behalf of consenting eligible customer accounts as part of its management of a portfolio that also contains instruments that are not regulated by the CFTC. Of particular interest to the Institute, as proposed, the list of eligible account managers would include investment advisers registered with the Securities and Exchange Commission ("SEC"), and SEC-registered investment companies would qualify as eligible institutional customers. Consistent with the Commission's intent, which is "to permit account managers to provide equivalent treatment to customers' accounts traded pursuant to strategies involving activities in both futures markets and securities markets," the proposal would give investment advisers

[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 6,860 open-end investment companies ("mutual funds"), 441 closed-end investment companies and 10 sponsors of unit investment trusts. Its mutual fund members have assets of about $4.419 trillion, accounting for approximately 95% of total industry assets, and over 62 million individual shareholders.

[2] *See* Letter from Frances M. Stadler, Assistant Counsel, Investment Company Institute, to Ms. Jean A. Webb, Secretary, Commodity Futures Trading Commission, dated July 21, 1993.

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more flexibility with respect to their allocation of futures orders for their institutional clients and would allow them to use more consistent allocation procedures in both their securities and futures trades. Providing this flexibility is desirable and may eliminate unnecessary costs and administrative burdens.

When the Commission previously published proposed amendments to Rule 1.35(a-1) for comment, the Institute expressed concern with provisions in the proposal that would: (1) limit eligibility to only "intermarket" orders; (2) prohibit otherwise eligible accounts from being eligible if any of an extensive list of persons (including the investment adviser, the FCM allocating the order, certain of their affiliated companies, employee benefit plans, officers and stockholders, as well as any employee of the adviser or FCM who "affects or supervises the handling of the order" and various family members of such an employee) had any "interest" in the account or in "any related securities account;" and (3) require an account manager, before placing an initial order, to certify several items in writing to the FCM allocating the order.

Revisions made to the Commission's proposal since it was first published for comment address each of the items listed above. In particular, the Commission has:

- deleted the term "intermarket" as the descriptive term used to identify eligible orders. Instead, the Commission has proposed that, to be eligible, an order must be placed as part of the management of a portfolio also containing instruments that are either exempt from regulation pursuant to the Commission's regulations or excluded from the Commission's regulation under the Act;

- replaced the prohibition against certain persons' having a proprietary interest in an eligible account with a provision that would permit such persons,[3] in the aggregate, to have up to a ten percent interest in such account; and

- reduced the required account manager certification to one: the account manager must certify in writing to each FCM executing and/or allocating any part of an eligible order that the manager is aware of the provisions of the rule and will remain in compliance with its requirements.

These revisions resolve our previous concerns with respect to "intermarket" orders and account manager certification. With respect to proprietary interests in an eligible account, however, we remain concerned that compliance by investment advisers to registered investment companies would present difficult challenges.

Our letter on the original proposal discussed the practical difficulties that would result from a complete prohibition on certain persons' having any proprietary interest in an eligible account. These practical problems arise whether there is a complete prohibition or a ten percent threshold is imposed. The letter provided an example that bears repeating here, concerning reliance on the proposal by an investment adviser to investment companies. The

[3] The Commission also eliminated employee benefit plans of the account manager, the FCM allocating the order, or their affiliates, from the list of persons subject to the proprietary interest restriction.

example indicated that under the proposal, the adviser could be required to determine, potentially on a daily basis, not only whether the John Smith from Tennessee is married to (or the brother, father, or son of) Jane Smith who works on an FCM's trading desk in Chicago, but also whether a broker who maintains a "street name" or omnibus account with the investment company is investing on behalf of Jane Smith, whether a bank trust department that invests under a nominee name is investing Jane Smith's non-discretionary trust account, and whether Jane Smith is a participant in a retirement plan that establishes an account with the investment company in the name of the plan trustee -- and, if so, either to refuse the trade before the end of the business day or to immediately change the way the investment company trades with Jane Smith's FCM. As a further complication, our letter noted, the identity of beneficial owners of shares often is confidential information that the nominal account owner may be unwilling to provide to the investment company. If investment companies are unable to track such ownership with confidence, we stated, there would be no way for the account manager (*i.e.*, the investment adviser) to be sure that the proposed end-of-day allocation methodology is legally permissible at any given time.

Although the revised proposal would allow various specified persons, in the aggregate, to have up to a ten percent interest in a participating eligible account, thereby providing some leeway, an investment adviser still would have to be aware of and monitor such interests continuously to assure compliance with the requirement.[4] Yet, as we indicated previously, in situations such as those described in the example set forth above, it would be very difficult, and in some cases impossible, to determine ownership interest and monitor compliance with the ten percent limitation. Under normal circumstances, except in the case of new investment companies, it seems unlikely that the ten percent threshold would be reached. Nevertheless, the investment adviser would be placed in the untenable position of having to certify its compliance with the regulation (including the ten percent threshold) while having no ability to determine compliance with certainty.

We suggest that the Commission consider further refining the proposal to address this concern. One possible approach might be to exclude interests in registered investment companies from the restriction, on the theory that such companies, because they are subject to a comprehensive regulatory scheme under the Investment Company Act and typically have widespread public ownership, would not lend themselves to the self-dealing abuses that the restriction is intended to address.[5] Indeed, the Investment Company Act contains provisions

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[4] In addition, a new investment company in which an investment adviser has a ten percent or greater interest -- because it has provided the initial seed capital to the company -- could not rely on the regulation, even as it has been revised. We understand that it is not uncommon for investment companies to seek to invest in futures during the start-up phase.

[5] Alternatively, the Commission could modify the certification requirement in the proposal to provide that an account manager must certify that it *reasonably believes* it is in compliance with the requirements of the regulation.

specifically designed to prohibit self-dealing[6] and, therefore, it seems unnecessary to overlay an additional regulatory scheme for this purpose.[7]

If the Commission is not inclined to exclude registered investment companies from the restriction on proprietary interests in an eligible account, we further recommend that, for purposes of determining who has an "interest" in an eligible account, the Commission clarify that interests held in a fiduciary capacity are attributed only to the beneficial owner and not to the fiduciary. For example, where a bank serves as investment adviser to an investment company and invests trust assets (as to which it has investment discretion and nominal voting authority) in that investment company, the trust assets should be considered the interest of the trust and not the bank. Otherwise, if the interest were ten percent or greater and were attributed to the bank in this example, the investment company would be precluded from participating in a bunched order, which potentially would conflict with the bank's fiduciary responsibility to act in the best interests of its clients.

Finally, we recommend that the Commission clarify the following issues in its adopting release:

- First, with respect to the requirement that account managers obtain advance written consent from eligible customer to the placement, execution and allocation of their orders in accordance with the amended rule, we recommend that the Commission clarify that this requirement would be satisfied where a registered investment adviser discloses its bunching and allocation policies in its Form ADV, an eligible customer provides written acknowledgment that it has read the Form ADV, and there is no indication in such acknowledgment that the customer objects to such policies.

- Second, while the proposal would require an account manager, before placing the initial eligible order, to provide each FCM with "a list of eligible futures accounts", the Institute recommends that, rather than requiring a *cumulative* list of such accounts (which may have to be continuously amended and updated), the Commission permit an account manager to provide the FCM such information on an account either when it is opened or once a determination is made that it is an eligible account for purposes of the rule. This method of reporting should ensure that the FCM is aware of which accounts are eligible accounts and, when such information is coupled with the rule's proposed account manager certification, should provide the FCM adequate information to ensure compliance with the proposed rule.

- Third, for purposes of the proposed requirement that account managers make available, upon the request of any eligible customer, data sufficient to allow the customer to compare

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[6] *See, e.g.,* Section 17 of the Investment Company Act. The Institute believes that this proposed treatment of investment companies would be consistent with the Commission's treatment of employee benefit plans, which, according to the Release, were deleted from the restriction in the rule relating to proprietary interest because such "plans are subject to strict ERISA regulations."

[7] The Commission previously has relied on the comprehensive regulation of registered investment companies under the Investment Company Act CFTC Rule 4.5. Rule 4.5 excludes certain otherwise regulated entities, including registered investment companies, from the definition of "commodity pool operator."

its results with those of other relevant customers, we recommend that the Commission clarify that aggregated or composite information may be provided.

The Institute appreciates the Commission's consideration of and responsiveness to the concerns we raised with the previous proposal. We also thank you for your consideration of our current comments. If you have any questions concerning them, you may contact me at 202/326-5825.

Sincerely,

Tamara K. Reed

Tamara K. Reed
Associate Counsel