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VIA ELECTRONIC MAIL

Mr. Daniel A. Driscoll
Executive Vice President,
Chief Operating Officer

Mr. Thomas W. Sexton, III
Senior Vice President,
General Counsel and Secretary

National Futures Association
300 S. Riverside Plaza, #1800
Chicago, Illinois 60606-6615

Re: CPO/CTA Capital Requirement and Customer Protection Measures

Dear Messrs. Driscoll and Sexton:

The Asset Management Group ("AMG") of the Securities Industry and Financial Markets Association[1] appreciates the opportunity to respond to the recent Notice to Members (the "NTM") by the National Futures Association ("NFA") that requests comments concerning possible capital requirements and other customer protection measures for registered commodity pool operators ("CPOs") and commodity trading advisers ("CTAs").[2] The NTM explains that NFA is evaluating potential regulatory responses to recent membership responsibility actions ("MRAs") against certain CPOs and CTAs that are members of NFA ("CPO/CTA member firms"). We have carefully reviewed the MRAs and agree with NFA that they present legitimate concerns about fraud and mismanagement of client assets. However, we believe that those concerns cannot be ameliorated by a capital requirement or the other measures discussed in the NTM.

Capital requirements are intended to offer protection against credit risks presented by brokers and dealers when they act as agents or counterparties to transactions in financial instruments, including commodity interests; they are not designed to prevent the fraud and other

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[1] AMG's members represent U.S. asset management firms whose combined assets under management exceed $30 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector pension funds, and private funds such as hedge funds and private equity funds.

[2] NFA Notice I-14-03, Request for Comments – CPO/CTA Capital Requirement and Customer Protection Measures (Jan. 23, 2014).

misconduct of the sort described in the MRAs. Rather, that type of misbehavior can be better addressed through enforcement of existing legal and regulatory requirements. AMG also believes that the capital requirement and the other measures suggested in the NTM fail to consider the legal protections and operational controls under which asset managers operate today.

If NFA were to adopt any of the measures suggested in the NTM, CPO/CTA member firms would be subject to substantially higher costs and greater operational complexity. AMG believes that those measures would not materially enhance the protections afforded by the current legal and operational framework for asset managers. Among other things, those increased costs and requirements could put smaller industry participants at a disadvantage.

The universe of asset managers that are now CPO/CTA member firms has grown considerably since 2012, because of the addition of "swaps" as commodity interests subject to the Commodity Exchange Act (the "CEA")[3] and the substantial amendments made to CFTC Regulation 4.5 with regard to CPOs of registered investment companies and the rescission of the exemption from CPO registration provided by former CFTC Regulation 4.13(a)(4).[4] Accordingly, NFA regulates a much larger and more diverse group of member firms than ever before. AMG members that are registered as CPOs or CTAs are asset managers that are also registered with the Securities and Exchange Commission (the "SEC") as investment advisers under the Investment Advisers Act of 1940 (the "Advisers Act") and can be subject to other legal and regulatory requirements, such as the Employee Retirement Income Security Act of 1974 ("ERISA").

AMG believes that the added burdens for these CPO/CTA member firms, in particular, are wholly unwarranted, especially given the fiduciary standards and other regulatory obligations to which these members are subject. The fiduciary standards by which our members are bound, whether under the Advisers Act or ERISA, instill in them a culture of compliance – a culture that would not be enhanced at all by the measures NFA suggests in the NTM.

This letter addresses each of the measures on which the NTM requests comment. In doing so, it articulates how the general concerns set forth above would manifest themselves were those responses to be adopted.

I. CPO/CTA Capital Requirement

A. *A Capital Requirement for CPO/CTA Member Firms Is Inappropriate and Unnecessary.*

The NTM requests comment on whether CPO/CTA member firms should be required to maintain minimum net capital. AMG strongly opposes a capital requirement for CPO/CTA member firms.

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[3] *See* 77 Fed. Reg. 66288 (Nov. 2, 2012) .

[4] *See* 77 Fed. Reg. 11252 (Feb. 24, 2012).

Capital Requirements Are More Appropriate For Financial Intermediaries Than For Registered CPOs/CTAs. Asset managers, including registered CPOs and CTAs, operate under a different business model than the brokers and dealers in financial instruments to which regulatory capital requirements have historically applied. Regulatory capital requirements are intended to reduce credit risk arising from financial intermediaries that have trading relationships with customers and counterparties, such as broker-dealers.[5] They are designed to ensure that those intermediaries have sufficient liquid assets to cover their current obligations. Asset managers do not guarantee or finance their clients' trades. Rather, asset managers provide advisory and asset management services to funds (pools) and accounts for a fee. When asset managers act with discretionary authority to trade on behalf of their clients, they do so through intermediaries or with counterparties to which capital requirements do apply, such as SEC-registered broker-dealers and FCMs.

Asset managers also routinely obtain professional liability insurance to protect themselves against claims by their clients for alleged harms. Those insurance policies provide a measure of protection against claims that might otherwise impair an asset manager's ability to operate its business. In addition, ERISA requires benefit plan fiduciaries, including asset managers, to be bonded.[6] The Investment Company Act of 1940 (the "Investment Company Act") requires a registered investment company to maintain fidelity bond coverage with respect to its employees and officers who have access to the company's funds and securities; in practice, this requirement applies to personnel of the investment company's asset manager.[7] NFA should evaluate whether these practices and requirements with respect to insurance coverage obviate the perceived need for a capital requirement.

The Capital Requirement for Introducing Brokers Is Not Instructive for CPOs and CTAs. The NTM suggests that a capital requirement may be appropriate for CPO/CTA member firms because the CFTC has imposed a capital requirement on introducing brokers. In this regard, the NTM explains that introducing brokers are prohibited from handling customer funds yet are subject to a capital requirement. As CPO/CTA member firms may control or manage client accounts, the reasoning goes, a capital requirement may be appropriate for them as well. We believe this is an inapt comparison.

CPO/CTA member firms are already subject to a comprehensive regulatory regime. When the CFTC determined to impose a capital requirement on introducing brokers in 1983, introducing brokers were not subject to any regulation in connection with their commodity interest activities. At the time, the CFTC was concerned about the "networks of unregistered

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[5] In this connection, the SEC requires broker-dealers to maintain a minimum amount of net capital at all times pursuant to Rule 15c3-1 under the Securities Exchange Act of 1934. *See, e.g.*, 32 Fed. Reg. 856 (Jan. 25, 1967); 78 Fed. Reg. 51824 (Aug. 21, 2013). The CFTC has imposed capital requirements on futures commission merchants ("FCMs") for substantially the same reason. *See* 17 C.F.R. § 1.17(a)(1); *see also* 43 Fed. Reg. 39956 (Sept. 8, 1978); 74 Fed. Reg. 69279 (Dec. 31, 2009). The proposed capital requirements for swap dealers and security-based swap dealers would serve a similar purpose. *See* 77 Fed. Reg. 70213 (Nov. 23, 2012).

[6] *See* Section 412 of ERISA, 29 U.S.C. § 1112; *see generally* 29 C.F.R. pt. 2550.

[7] *See* Section 17(g) of the Investment Company Act, 7 U.S.C. § 80a-17(g); 17 C.F.R. § 270.17g-1.

'agents'" of FCMs "whose principal function was to procure customer business" for FCMs.[8] It was natural for the CFTC to borrow from the existing FCM rule set when creating regulations to apply to introducing brokers for the first time.[9]

The CFTC also distinguishes between introducing brokers, on the one hand, and CPOs and CTAs, on the other, in applying its substantive regulatory requirements. The CFTC excludes from the "introducing broker" definition, and thus from its introducing broker regulations:

> Any [CTA], which, acting in its capacity as a commodity trading advisor, is not compensated on a per-trade basis or which solely manages discretionary accounts pursuant to a power of attorney, regardless of whether that [CTA] is registered or exempt from registration in such capacity; and
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> Any [CPO] which, acting in its capacity as a [CPO], solely operates commodity pools, regardless of whether that [CPO] is registered or exempt from registration in such capacity.[10]

AMG believes that these distinctions are highly relevant to NFA's suggestion of a potential capital requirement. CPO/CTA member firms are already subject to a comprehensive regulatory regime, one that does not borrow from concepts – like regulatory capital – that have historically applied to financial intermediaries like FCMs. Indeed, the regulations governing CPO/CTA member firms tend to mirror those that have historically applied to asset managers registered with the SEC under the Advisers Act.

Asset Managers Are Already Subject to Robust Controls Over Client Assets. The MRAs cited in the NTM raise fundamental concerns about misuse of client funds. But only one firm sanctioned in the MRAs was an SEC-registered investment adviser, and its conduct was plainly fraudulent.[11] Today, as a result of CFTC rule changes that were implemented in 2012,[12] many firms that are registered with the SEC as investment advisers under the Advisers Act are registered CPOs or CTAs, including CPOs and CTAs among AMG's membership. SEC-registered firms have been subject to long-standing regulatory requirements that are designed to address their business activities.

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8 48 Fed. Reg. 14933, 14933 (Apr. 6, 1983).

9 Unlike in the case of registered CPOs and CTAs, the CEA specifically authorizes the adoption of capital requirements for introducing brokers. *See* Section 4f(b) of the CEA, 7 U.S.C. § 6f(b). AMG questions whether moving forward with a proposal for capital requirements for registered CPOs and CTAs would be appropriate in the absence of specific authorization by Congress or, at the very least, the CFTC.

10 17 C.F.R. § 1.3(mm)(2)(ii)-(iii) (emphasis added).

11 *See* In the Matter of Alphametrix LLC, NFA Case No. 13-MRA-007 (Oct. 21, 2013).

12 *See* 77 Fed. Reg. 11252 (Feb. 24, 2012) (amendments to CPO/CTA compliance obligations); 77 Fed. Reg. 66288 (Nov. 2, 2012) (adaption of CFTC regulations to incorporate swaps).

In particular, SEC-registered investment advisers are subject to comprehensive requirements concerning custody of client assets, which were updated as recently as December 2009 in the wake of the Madoff scandal.[13] For this purpose, "custody" is defined broadly to include holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them. Under this definition, even solely having authority to deduct fees from client accounts is considered custody.[14]

Under the Advisers Act, an asset manager has certain requirements with respect to custody of client assets. For example, an asset manager is required to keep client assets with a "qualified custodian" in a segregated account.[15] In addition, an asset manager must notify its clients in writing that their assets are held with a qualified custodian and must perform appropriate inquiries to establish a reasonable belief that the qualified custodian sends periodic account statements to the asset manager's clients concerning their assets. Client assets are also subject to verification once a year by an independent public accountant, with the verification to take place at a time chosen by the accountant and without notice to the asset manager; the accountant is required to report to the SEC the results of the verification process. In the case of a client that is a fund, the notice, due inquiry, and verification requirements can be satisfied if the fund is audited by an independent public accounting firm and sends its audited annual financial statements to its investors.[16]

Additional requirements apply if the asset manager or a related person of the asset manager serves as qualified custodian for client funds or securities, including a requirement to obtain annually a written report from an independent public accountant regarding the effectiveness of the design and operation of controls concerning the safeguarding of client funds and securities. There are also safekeeping requirements that apply to clients of asset managers that are investment companies registered under the Investment Company Act.[17]

The CFTC's regulations also address these matters. They require a CPO to treat funds, securities, and other property contributed to a commodity pool as belonging to that pool.[18] They also prohibit a CTA from receiving client funds, securities, and other property in its own name for the purpose of transacting in commodity interests.[19]

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[13] *See* 17 C.F.R. § 275.206(4)-2; *see also* 75 Fed. Reg. 1456 (Jan. 11, 2010).

[14] An adviser would also be considered to have custody of any client securities or funds that are held directly or indirectly by a "related person" (i.e., anyone who controls, is controlled by, or is under common control with the adviser.)

[15] The term "qualified custodian" is defined in Rule 206(4)-2 under the Advisers Act to include banks, broker-dealers, FCMs, and foreign financial institutions that customarily hold customer financial assets.

[16] *See* 17 C.F.R. § 275.206(4)-2.

[17] *See* Section 17(f) of the Investment Company Act, 15 U.S.C. § 80a-17(f); *see also* 17 C.F.R. §§ 270.17f-1 – 270.17f-7.

[18] *See* 17 C.F.R. § 4.20(b)-(c).

[19] *See* 17 C.F.R. § 4.30(a).

AMG believes that these existing requirements already address, in a comprehensive fashion, the concerns about misuse of client assets raised in the NTM.

B. *A Capital Requirement Would Not Address the Core Issues of Fraud, Theft, and Mismanagement Identified in the MRAs.*

The NTM explains that, over the past three years, NFA has brought 23 MRAs against CPO/CTA member firms, which constitutes approximately 92 percent of all MRAs during that period. The NTM contends that a capital requirement may be appropriate given the gravity of the wrongdoing and the high percentage of CPO/CTA member firms involved in the misconduct.

<u>A Capital Requirement Will Not Prevent Fraud</u>. The MRAs do raise serious concerns, but AMG believes that the type of misconduct they involve would not be forestalled by imposing a capital requirement on registered CPOs and CTAs. A review of the MRAs bears this out:

- Nineteen of the MRAs involved firms that failed to produce any books or records, failed to respond to NFA, or provided false or misleading information to NFA.
- Nineteen of the MRAs involved separate actions against associated persons for their roles in fraudulent conduct and management by the CPO/CTA member firms.
- Ten of the MRAs alleged the use of client assets for personal gain.
- Three MRAs indicate that the conduct was so egregious that NFA was unable to determine the location of pool assets.

AMG submits that a capital requirement, no matter how well-intentioned, could not reasonably be expected to offer meaningful protection against this sort of misconduct. Recent history is replete with instances in which firms subject to capital requirements have nonetheless engaged in fraud, theft, and other misuse of customer funds. Those cases underscore the point that capital requirements are not able to prevent or ameliorate the kind of wrongdoing identified in the MRAs.

<u>The NTM Relies on a Small and Outdated Sample of Firms</u>. As noted above, there has been a dramatic increase in the number of asset managers that have registered as CPOs and CTAs and joined NFA since December 2012 as a result of the addition of "swaps" as commodity interests subject to the CEA,[20] the substantial amendments made to CFTC Regulation 4.5 with regard to CPOs of registered investment companies,[21] and the rescission of the exemption from CPO registration provided by former CFTC Regulation 4.13(a)(4).[22] As a result of these rule changes, the number of CPOs and CTAs registered with NFA is now a multiple of, and a much more diverse group than, those that were registered even two years ago. Moreover, fifteen of the

[20] *See* 77 Fed. Reg. 66288 (Nov. 2, 2012).

[21] *See* 77 Fed. Reg. 11252 (Feb. 24, 2012).

[22] *Id.*

23 MRAs that the NTM cites were decided prior to December 31, 2012, which means they relate to conduct that occurred before these recent rule changes took effect.

In addition, as mentioned above, only one of the MRAs involved a CPO/CTA member firm that was an SEC-registered investment adviser. Because the firms in the other 22 MRAs were not subject to the Advisers Act requirements, the MRAs do not provide a meaningful basis for assessing whether any new requirements should be applied to a universe of CPOs and CTAs that now includes a significant number of registered investment advisers.

Accordingly, AMG believes that NFA should reconsider whether those 23 MRAs provide an appropriate basis for imposing a capital requirement on all of NFA's 1,640 CPO member firms and 1,046 CTA members firms.[23] Fundamentally, it would not be equitable for all firms to suffer a capital requirement as the perpetual consequence of misconduct by a few bad actors, even if capital requirements could be effective to mitigate the risk of this misconduct. As discussed above, we question whether capital requirements could be effective to reduce the risk of this misconduct, even among the few bad actors. Instead, it would seem more prudent for MRAs and rigorous enforcement to serve as a deterrent to future misconduct.

II. Other Customer Protection Measures

A. *Independent Third Party Authorization for Disbursements of Pool Funds*

The NTM raises for consideration a requirement for an independent third party to review and authorize a CPO's "disbursement" of pool funds. AMG believes that such a requirement would usurp the role of the CPO as the operator of the commodity pool. The NTM neither proposes a definition of "disbursement" nor suggests any limitation on that term. As a result, any third-party approval requirement could apply to almost any use of pool funds for any purpose, including standard business operations. This could require, for instance, external authorization for investment decisions and, effectively, the outsourcing of those decisions and other necessary elements of the CPO's day-to-day operations. This requirement would inevitably lead to delays that would undermine investment strategies and potentially diminish investor returns. It could also result in an industry-wide (and costly) renegotiation of custodial arrangements to permit these third parties to review and potentially overrule decisions respecting assets held in custody.[24]

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[23] *See* http://www.nfa.futures.org/NFA-registration/NFA-membership-and-dues.HTML. NFA may also wish to consider a recent analysis cited by the CFTC, in adopting rules further defining the term "eligible contract participant" in Regulation 1.3(m), which suggests a higher incidence of enforcement cases among smaller retail forex pools. *See* 77 Fed. Reg. 30596, 30659 and n.729 (May 23, 2012).

[24] Third-party review may also present undue complications in a trust company structure, in which the trustee must retain investment discretion even though it has appointed an investment manager. Although the trustee may issue a standing instruction that the investment manager's advice be implemented, the added layer of third-party review would have the potential to delay investments and other routine decisions respecting trust company assets.

Such a requirement would also undermine, in many important respects, the contractual and other legal arrangements between the pool and the CPO, in which the former (whether through its board or other governing authority) expresses its desire for professional management to be provided by the latter. Giving a third party the power to review decisions of the professional manager that a pool has freely retained would deprive the pool of the benefit of the bargain – whether those decisions are actually countermanded or simply influenced by the third party's presence in the arrangement. It is also unclear by what standard these third parties would measure whether they have effectively discharged their duties.[25]

Whether or not "disbursement" would include investment decisions, a third-party approval requirement would complicate routine pool functions, would be likely to increase operational errors, and would increase costs borne by pool investors. Third party authorization would also appear to be unnecessary to protect client assets, given the custody and safekeeping requirements described above that apply under the Advisers Act, the Investment Company Act, and CFTC regulations applicable to CPOs and CTAs.

The suggestion that third parties should review disbursements also tends to overlook the considerable power that clients have over their relationships with asset managers. For instance, clients receive audited financial information concerning their accounts. This degree of transparency enables clients to ask close questions about how their assets are spent, which means that managers must seek to control and substantiate their fees and associated expenses.

In addition, under the Investment Company Act, the advisory agreement for a registered investment company is subject to annual approval (after an initial two-year term) by the investment company's board of directors.[26] Most registered investment companies have boards that consist of a majority of directors that are independent of the investment company's investment adviser.[27] On a fundamental level, AMG questions whether a commodity pool could put in place contractual or other protections with a third-party reviewer of disbursements that would be sufficient to protect its interests. In the absence of those protections, a board of directors or other fiduciary may not accept an arrangement in which important decisions concerning a commodity pool's assets are effectively ceded to a person that may not be charged with acting in the best interests of the commodity pool. Power over disbursements is further constrained if a fund (or separate account) has multiple managers – i.e., each firm would have control over a limited portion of client assets. The competition among firms for advisory business also presents clients with a variety of choices should they ever wish to consider replacing their current asset manager. As the assets of a fund or account are typically held at an independent, third-party custodian, asset managers can be easily substituted and replaced.

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[25] In this way, such a requirement could call into question the very foundation of the fiduciary relationship between asset managers and their clients.

[26] *See* Section 15(c) of the Investment Company Act, 15 U.S.C. § 80a-15(c).

[27] "As of year-end 2012, independent directors made up three-quarters of boards in 85 percent of fund complexes." Independent Directors Council and Investment Company Institute, Overview of Fund Governance Practices, 1994-2012, at 1, *available at* http://www.idc.org/pdf/pub_13_fund_governance.pdf.

Finally and very importantly, the rationale for third-party review of disbursements should also be evaluated in light of the current control environment to which asset managers are subject. For example:

- Asset managers typically engage accounting firms to conduct reviews of their controls that are relevant to their clients' own financial reporting.[28]

- It is customary for asset managers to have internal audit functions that review the integrity of accounting matters, including expenditures of client assets.

- The Advisers Act and the Investment Company Act require registered investment advisers and registered investment companies, respectively, to have a chief compliance officer ("CCO").[29] The CCO in each case must administer a compliance program that addresses matters such as custody of client assets, as well as other legal and regulatory requirements. The CCO of a registered investment company must meet separately with the investment company's board at least once a year to discuss compliance issues, including matters such as custody.

AMG believes that the legal requirements and associated operational controls discussed above make third-party review of fund disbursements unnecessary.

B. *Valuation and Monthly or Quarterly Reporting*

The NTM solicits comment on the processes used to value and report on commodity pool assets. In response, AMG wishes to highlight the following mechanisms currently in place that seek to ensure that valuation matters are handled properly and the current reporting requirements applicable to asset managers and their funds:

- As discussed above, investment funds, whether registered under the Investment Company Act or not, typically hold their assets at a third-party bank or other qualified custodian. The custodian is responsible for preparing and transmitting account statements concerning the assets it holds.

- Third-party administrators for private investment funds often are responsible for calculating the funds' net asset value.

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[28] These audits are conducted pursuant to AICPA audit standards known as Standards for Attestation Engagements (SSAE) 16, Reporting on Controls at Service Organizations. *See generally* AICPA, Service Organization Controls: Managing Risks by Obtaining a Service Auditor's Report (Feb. 2013), *available at* http://www.aicpa.org/interestareas/informationtechnology/resources/trustservices/downloadabledocuments/10957-378%20soc%20whitepaper.pdf.

[29] *See* 17 C.F.R. §§ 270.38a-1 and 275.206(4)-7.

- Registered open-end investment companies (mutual funds) strike their net asset values daily and make that information available to investors. [30] This function is subject to a comprehensive control environment administered by the CCO.[31]

- Purchases and sales of individual shares of exchange-traded funds registered under the Investment Company Act ("SEC-Registered ETFs") are effected at market prices rather than at net asset value. But, on a daily basis, SEC-Registered ETFs also issue baskets of shares – known as "creation units" – at net asset value in exchange for securities and cash and publish these net asset values as a matter of course.[32]

- Registered investment companies must generally file with the SEC quarterly reports of their investment holdings. In addition, ETFs relying on exemptive relief from the SEC are often required to publish their holdings daily.[33]

- Investment funds, whether registered under the Investment Company Act or not, generally have their financial statements audited annually by an independent public accountant. This is a requirement for registered investment companies. [34]

- CFTC regulations applicable to CPOs require monthly or quarterly signed account statements to be distributed to pool investors, and for CPOs to file and distribute audited annual financial statements.[35]

- Specific standards adopted by the Public Company Accounting Oversight Board (the "PCAOB") apply to accounting firms when they review fair value determinations by public company clients such as registered investment companies.[36]

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[30] *See* 17 C.F.R. § 270.22c-1(b)(1).

[31] As one example of this control environment, many registered investment companies follow well-established procedures for determining whether, when, and how to correct errors in their net asset values. The asset management industry generally treats one-penny-per-share as a standard of materiality for the purpose of correcting net asset value errors. *See, e.g.,* Buffalo Funds, SEC Staff Comment Letter (Sept. 15, 2010). Registered investment companies also disclose their valuation procedures, including with respect to fair valuation, in their publicly available prospectuses and statements of additional information.

[32] This requirement is a condition of exemptive relief that the SEC has granted to ETFs. *See, e.g.,* Index ETF Exemptive Application for WisdomTree, Sections II.K.2 and II.Q, *available at* http://www.sec.gov/Archives/edgar/data/880631/000119312513447117/d629677d40appa.htm; Active ETF Exemptive Application for USAA, Section I.I, *available at* http://www.sec.gov/Archives/edgar/data/732910/000090869514000002/etf_amendment.htm.

[33] *See generally* Investment Company Act Notices and Orders*, available at* http://www.sec.gov/rules/icreleases.shtml#etf-active.

[34] *See* Section 30(g) of the Investment Company Act, 15 U.S.C. § 80a-29(g).

[35] *See* 17 C.F.R. §§ 4.7 and 4.22.

[36] *See* PCAOB, AU Section 328, Auditing Fair Value Measurements and Disclosures, *available at* http://pcaobus.org/Standards/Auditing/Pages/AU328.aspx. Paragraph .23 of AU Section 328 describes the general approach to testing fair value determinations:

Given the comprehensive scope of these requirements, AMG believes that NFA should not adopt any additional requirements regarding valuation and reporting of pool assets.

C. *Performance Results*

The NTM requests comment on the manner in which commodity pool performance results are prepared and asks whether third-party preparation or verification of those results would be a prudent measure to prevent misleading disclosures or misappropriation. AMG notes that asset managers generally prepare performance results in-house, as doing so is an intrinsic part of the fund management process. AMG also notes that the SEC does not require investment advisers or investment companies to submit their performance disclosures for external review or to have their performance results calculated by a third party.[37]

However, asset managers and their funds are subject to several requirements surrounding the preparation of performance results, including the following:

- Registered investment companies are subject to detailed requirements mandated by the SEC under the Investment Company Act for the calculation of their performance.[38]
- Investment funds that are not registered under the Investment Company Act typically prepare their performance results in accordance with Global Investment Performance Standards, or GIPS, which are a standardized approach to calculating and reporting investment results administered by the CFA Institute.[39] The SEC's Office of Compliance Inspections and Examinations reviews claims of compliance with GIPS through its inspections of registered investment advisers.

Based on the auditor's assessment of the risk of material misstatement, the auditor should test the entity's fair value measurements and disclosures. Because of the wide range of possible fair value measurements, from relatively simple to complex, and the varying levels of risk of material misstatement associated with the process for determining fair values, the auditor's planned audit procedures can vary significantly in nature, timing, and extent. For example, substantive tests of the fair value measurements may involve (*a*) testing management's significant assumptions, the valuation model, and the underlying data (see paragraphs .26 through .39), (*b*) developing independent fair value estimates for corroborative purposes (see paragraph .40), or (*c*) reviewing subsequent events and transactions (see paragraphs .41 and .42).

[37] NFA may wish to consider in this regard the considerable extent to which the CFTC determined that it will permit CPOs to substitute compliance with SEC rules under the Investment Company Act for registered investment companies with respect to requirements that would otherwise apply under the CFTC's Part 4 regulations, including performance disclosures. *See* 78 Fed. Reg. 52308, 52312 (Aug. 22, 2013).

[38] *See* SEC Form N-1A, Item 26, Calculation of Performance Data; 17 C.F.R. § 230.482(b)(3); 17 C.F.R. § 270.34b-1(b).

[39] *See* http://www.gipsstandards.org/about/history/Pages/index.aspx.

- Asset managers and their funds are required to retain records concerning their calculations of performance results.[40] Those records are subject to review on request by the SEC.

Any effort to export the preparation of commodity pool performance results or to subject them to outside review would be costly, time-consuming, and unnecessary; it is unclear to us how doing so could improve the quality of reporting in any material way.

D. *Verification of Pool Assets*

The NTM solicits input on whether NFA should develop a system requiring daily reporting of pool assets to NFA, akin to the system recently adopted for daily reporting of customer account balances by FCMs.

AMG believes that such a system would be unnecessary and impractical. As explained above, asset managers have already put in place a comprehensive control environment that places particular emphasis on the safekeeping and verification of client assets. Asset managers also undertake a reconciliation process when determining the net asset values of fund clients, particularly for mutual funds that strike their net asset values daily, as well as for separate account clients.

Moreover, AMG's CPO members have recently begun reporting information to the CFTC and NFA on Form CPO-PQR. NFA may wish to evaluate whether information reported on that Form, as well as the type of information reported on SEC Form PF, could more effectively serve its regulatory interests. AMG also notes that the CFTC has begun evaluating the efficacy of its swap data reporting rules implemented under the Dodd-Frank Act.[41]

Finally, there would also be considerable practical challenges associated with any process requiring daily reconciliation and reporting to NFA. For example:

- A commodity pool may have assets held at multiple custodians and may have margin on deposit with multiple securities broker-dealers and FCMs. It may not be possible to complete the reconciliation and reporting process with respect to a single pool on a daily basis given the number of information sources that would be involved.

- It is unclear whether a CPO has the legal authority to compel a custodian to provide information to NFA necessary to undertake a reconciliation exercise.

- Certain information may not be available on a daily basis (e.g., funds that have substantial holdings in shares of third-party funds or that hold illiquid assets).

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[40] *See, e.g.,* 17 C.F.R. §§ 270.31a-1 and 275.204-2.

[41] *See, e.g.,* 79 Fed. Reg. 16689 (Mar. 26, 2014) (requesting comment on swap data recordkeeping and reporting requirements; comment period closing May 27, 2014).

- Commodity pools invest in securities and other assets that are not commodity interests, which may not be appropriate for inclusion in a complete reconciliation by NFA with respect to all pool assets.

- Different custodians and different brokers may value the same asset differently than a commodity pool might, further complicating the process.

In light of the forgoing considerations, AMG believes that NFA should not impose any verification process for commodity pool assets.

E. *Inactive Members*

The NTM notes that NFA expends regulatory resources on firms that do not carry on matters requiring ongoing CPO or CTA registration and asks whether those firms should be permitted to remain NFA members.

AMG believes that NFA should continue to permit inactive firms to remain NFA members. A CPO or CTA may choose to become a member but may be inactive for a period because it has yet to launch, or is between the management of, accounts or pools that require CPO or CTA registration and NFA membership. The ability to retain membership – and to carry the licenses of their associated persons – is a convenient way to permit firms flexibility to offer new products quickly. Maintaining a CPO or CTA registration also enables a firm to be prepared when a fund or an account increases its exposure to commodity interests above the level at which the firm can claim an exemption from CFTC registration. Given the recently-expanded universe of commodity interests regulated under the CEA and the recently-expanded scope of CPO and CTA registrants referenced above, this flexibility has become all the more important for asset managers.

AMG also notes that there is nothing in the definition of "commodity pool operator" or "commodity trading advisor" in the CEA that would preclude a firm from voluntarily registering or remaining registered – and, by extension, an NFA member – while inactive for a period of time.[42] AMG respectfully suggests that NFA explore measures short of withdrawing the memberships of firms that would allow NFA to preserve its regulatory resources.

III. Conclusion

For the reasons set forth above, AMG requests that NFA take no action with respect to the measures discussed in the NTM. Those measures are ill-suited to address the concerns that NFA has articulated, and they would impose additional and unnecessary burdens on asset managers that are CPO/CTA member firms.

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[42] *See* Section 1a of the Commodity Exchange Act, 7 U.S.C. §§ 1a(11)-(12). Each of those definitions includes "any person . . . who is registered with the Commission" as a CPO or a CTA as an alternative to the prongs defining a person as such based on its activities involving commodity interests.

AMG thanks NFA for the opportunity to comment on the NTM and for NFA's consideration of AMG's views. AMG would welcome the chance to discuss these comments further. Should NFA have any questions about this letter, please do not hesitate to call Tim Cameron of AMG at 212-313-1389 or Matt Nevins of AMG at 212-313-1176. NFA may also contact AMG's outside counsel in this matter, Daniel Budofsky at 212-705-7546 and Joshua Sterling at 202-373-6556, of Bingham McCutchen LLP.

Sincerely,

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