

**STATEMENT OF THE INVESTMENT COMPANY INSTITUTE
ON THE U.S. COMMODITY FUTURES TRADING COMMISSION'S
APPROPRIATIONS FOR FISCAL YEAR 2013**

**Subcommittee on Financial Services and General Government
Committee on Appropriations
U.S. Senate**

May 1, 2012

The Investment Company Institute¹ appreciates this opportunity to submit testimony to the Subcommittee relating to the Administration's FY 2013 Appropriations request for the Commodity Futures Trading Commission (CFTC). We support providing the CFTC with the resources it needs to protect investors in the derivatives markets, including mutual funds and other registered investment companies (funds), and to carry out its Congressionally-mandated responsibilities under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The CFTC, however, has requested an increase of more than 50% in its appropriation on the basis that the agency needs additional resources to meet its "expanded mission and scope."² This request for dramatically greater resources seems difficult to explain, much less justify, in light of the agency's recently electing, in the absence of *any* Congressional mandate or demonstrable need, to radically expand its regulatory activities through the adoption of recent amendments to Rule 4.5 under the Commodity Exchange Act (CEA).

Ill-Advised and Inappropriate Use of the CFTC's Limited Resources

On February 8, 2012, the CFTC adopted amendments to Rule 4.5 under the CEA, which historically has provided an exclusion from CFTC regulation as a commodity pool operator (CPO) for certain "otherwise regulated entities," including funds. The CFTC previously had implemented this exclusion in recognition of the comprehensive regulation to which funds are already subject under the federal securities laws that affects virtually every aspect of their operation. The recent amendments to Rule 4.5, which apply *only* to funds, will sharply curtail this exclusion.

The new rule significantly limits the ability of advisers to funds (all of which themselves are registered with the Securities and Exchange Commission (SEC)) to rely on the exclusion. The amendments will result in many advisers to funds that invest in commodity futures, commodity options, and swaps being required also to register with the CFTC and also to comply with its separate regime of disclosure, reporting, and recordkeeping, including new, extensive systemic risk reporting rules. Funds that are unable to satisfy the revised eligibility restrictions of Rule 4.5 will be subject to regulation and oversight by *both* the CFTC and the National Futures

¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$13.4 trillion and serve over 90 million shareholders.

² Chairman Gary Gensler, Chairman's Letter, President's Budget and Performance Plan for Fiscal Year 2013, dated February 13, 2012.

Association (NFA), *and* by their primary regulator, the SEC. This additional regulation is altogether unnecessary and unjustified. It also is largely redundant of the comprehensive regulation to which funds and their advisers are already subject. The CFTC failed to perform even the most basic tasks of an appropriate cost-benefit analysis in adopting the rule. For these and other reasons, ICI and the U.S. Chamber of Commerce have filed a legal challenge to the adoption of the Rule 4.5 amendments.³

Rule 4.5 will require the CFTC and NFA to devote significant resources to oversee these funds and their advisers, at a time when the CFTC *claims* to need *half-again as much taxpayer financing* to accomplish its core mission. In our judgment, the CFTC has not demonstrated, nor could it demonstrate, that appropriations sought to implement the great expansion of its regulatory activities through the recent amendment of Rule 4.5 will produce any meaningful benefit to investors or protections for the markets.

Rule 4.5 was Not Mandated by the Dodd-Frank Act

Regulatory responsibility for Rule 4.5 will have considerable long-term implications for the CFTC. A host of new registrants will increase the agency's workload, and regulatory oversight of these new registrants will place new demands on the CFTC's resources, at a time when the agency acknowledges that it does not have the staffing or budget to meet new responsibilities under the Dodd-Frank Act.⁴ It likewise will strain the resources of the NFA, which serves as the frontline regulator for CPOs. Indeed, the CFTC in this rulemaking disregarded the plain recommendations of members of this Congress that it focus on its Dodd-Frank mandate.⁵ We urge Congress to take this into account as it considers the agency's request for an additional \$100 million in taxpayer funds in the coming year.

The CFTC is requesting significant additional resources to meet its expanded responsibilities under the Dodd-Frank Act. Yet the amendments to Rule 4.5 were neither required nor contemplated by that Act.⁶ We agree with Commissioner Sommers that the CFTC's attempt to rationalize the adoption of Rule 4.5 on the basis of the Dodd-Frank Act is unpersuasive:

³ See Complaint, *Investment Company Institute, et al. v. CFTC*, Case No. 1:12-cv-00612 (D.D.C. Apr. 17, 2012).

⁴ See Testimony of the Honorable Gary Gensler, Chairman, Commodity Futures Trading Commission, Before the U.S. Senate Appropriations Subcommittee on Financial Services and General Government (March 21, 2012) (stating that "effectively overseeing these markets depends on adequate funding for the agency's expanded mission.").

⁵ See Letter from Frank D. Lucas, Chairman, Committee on Agriculture, and K. Michael Conaway, Chairman, Subcommittee on General Farm Commodities and Risk Management, to the Honorable Gary Gensler, Chairman, U.S. Commodity Futures Trading Commission, dated July 14, 2011 ("In light of the volume of rules that are required by Title VII, it is prudent to prioritize the time and resources of your staff. We recommend that you promulgate rules that are required before moving to rules that are not explicitly required by Dodd-Frank." (going on to describe Rule 4.5)).

⁶ The CFTC has attempted to describe the amendments as being "consistent with the tenor of the provisions of the Dodd-Frank Act," despite nothing in the statute even remotely alluding to the need for CFTC oversight of funds. *Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations*, 77 Fed. Reg. 11252, 11253 (Feb. 24, 2012); *correction notice published at* 77 Fed. Reg. 17328 (Mar. 26, 2012), *available at* <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-3390a.pdf>.

... Congress was aware of the existing exclusions and exemptions for CPOs when it passed Dodd-Frank and did *not* direct the Commission to narrow their scope or require reporting for systemic risk purposes. The Commission justifies the new rules as a response to the financial crisis of 2007 and 2008 and the passage of Dodd-Frank, yet there is *no evidence* to suggest that inadequate regulation of commodity pools was a contributing cause of the crisis, or that subjecting entities to a dual registration scheme will somehow prevent a similar crisis in the future.”⁷

Prior to the CFTC’s adoption of the amendments, Chairman Kingston repeatedly expressed his concern to Chairman Gensler that the amendments were not statutorily mandated by the Dodd-Frank Act, and urged that the rulemaking be delayed until major rulemakings required by Dodd-Frank were completed.⁸ This recommendation was not heeded. Instead, the CFTC, in the performance plan it submitted recently to Congress, stated that the redeployment of resources it plans in order to address “the surge of Dodd-Frank registrations and reviews . . . creates risks in its critical oversight roles.”⁹ Given the CFTC’s stated need for additional resources to manage its Dodd-Frank mandated responsibilities and its explicit acknowledgment that the resource constraints resulting from these responsibilities create risks in its existing oversight role, it is difficult to see how the agency can justify taking on significant *additional* responsibilities as a result of Rule 4.5, which clearly was *not* mandated by the Dodd-Frank Act.

The CFTC Has Not Justified the Need for Further Regulation

The CFTC has not justified the need for the additional regulatory burdens that Rule 4.5 will impose on funds and their advisers, and the additional resources it will require of the agency. It has not acknowledged the significant costs the rule will impose on funds, which ultimately will be borne by their shareholders. Nor has it explained how these shareholders, which already enjoy comprehensive protections under the federal securities laws, will benefit from this additional redundant layer of regulation. As recently as January, Chairman Kingston and Chairman Conaway stated that they “remain opposed to the promulgation of this rule without a

⁷ Commissioner Jill E. Sommers, *Dissenting Statement, Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations* (February 9, 2012), available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/sommersstatement020912a> (Sommers Dissenting Statement) (emphasis added).

⁸ Letter from Chairman Jack Kingston, Subcommittee on Agriculture, Rural Development, Food and Drug Administration, and Related Agencies, Committee on Appropriations, U.S. House of Representatives, and Chairman K. Michael Conaway, Subcommittee on General Farm Commodities and Risk Management, U.S. House of Representatives, to the Honorable Gary Gensler, Chairman, U.S. Commodity Futures Trading Commission, dated January 30, 2012 (2012 Kingston and Conaway Letter); Letter from Chairman Jack Kingston, Subcommittee on Agriculture, Rural Development, Food and Drug Administration, and Related Agencies, Committee on Appropriations, U.S. House of Representatives, Chairman K. Michael Conaway, Subcommittee on General Farm Commodities and Risk Management, U.S. House of Representatives, and Congressman Bill Owens, U.S. House of Representatives, to the Honorable Gary Gensler, Chairman, U.S. Commodity Futures Trading Commission, dated October 3, 2011 (2011 Kingston, Conaway, and Owens Letter).

⁹ Commodity Futures Trading Commission, *President’s Budget and Performance Plan, Fiscal Year 2013*, Prepared for the Committee on Appropriations (February 2012) (emphasis added).

thorough cost-benefit analysis because the proposed rule has the potential to create duplicative, unnecessary regulations.”¹⁰ These concerns have been realized, as have been the Congressmen’s concerns that the costs associated with the amendments “will likely result in higher costs for many of our constituents that have invested their savings in investment plans that have exposure to the futures markets.”¹¹ Members of the Senate have echoed these concerns about the CFTC’s cost-benefit analysis in requesting the inspectors general of several federal agencies, including the CFTC, to initiate a review of the economic analysis performed by their agencies because they were “troubled by the concerns raised by Commissioners at both the Commodity Futures Trading Commission and the Securities and Exchange Commission . . . about economic analysis at their agencies.”¹² We agree with Commissioner Sommers’ conclusion in her statement dissenting to the adoption of Rule 4.5 that the “[t]he rationale underlying a number of the decisions encompassed by the rules is sorely lacking . . . and is not supported by the existing cost-benefit analysis.”¹³ We do not believe that Congress should provide resources for a rule that the CFTC itself cannot adequately support.

Conclusion

We support providing the CFTC with the resources it needs to protect investors in the derivatives markets and satisfy its Congressionally-mandated responsibilities. We do not, however, believe the CFTC should be provided with additional resources to support new rulemaking or greatly expanded oversight responsibilities that are neither required by the Dodd-Frank Act, justified by any cost-benefit analysis, nor needed by funds in light of the comprehensive scheme of regulation to which they already are subject. We therefore urge Congress to take into consideration the CFTC’s unnecessary and ill-advised expansion of its regulatory mission through the adoption of amendments to Rule 4.5 as it evaluates the agency’s request for a more than 50% increase in its annual budget.

We appreciate your consideration of our views.

¹⁰ 2012 Kingston and Conaway Letter, *supra* note 8.

¹¹ 2011 Kinston, Conaway, and Owens Letter, *supra* note 8.

¹² Letter from Senators Richard Shelby, Mike Crapo, et al. to A. Roy Lavik, Inspector General Commodity Futures Trading Commission, et al., dated May 4, 2011. These concerns led Senator Shelby to introduce the Financial Regulatory Responsibility Act of 2011, which would hold financial regulators responsible for rigorous, consistent economic analysis on every new rule they propose. *See* S. 1615 (Sept. 22, 2011).

¹³ Sommers Dissenting Statement, *supra* note 7.