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July 21, 2011

Kevin P. Walek
Assistant Director
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Follow-up to July 6, 2011 Roundtable on CFTC Proposal to Amend Rule 4.5

Dear Mr. Walek:

Thank you for the opportunity to provide you with comments on some of the issues discussed at the recent roundtable held on July 6, 2011 on the CTFC Proposal to amend Rule 4.5 (the "Rule").

AQR Capital Management, LLC ("AQR") is an asset management company which, as of June 30, 2011, manages approximately $40 billion in assets through offerings across a range of investment products, including hedge funds and commodity pools. AQR is also the investment adviser to a family of mutual funds, the AQR Funds. One of the AQR Funds, the AQR Managed Futures Strategy Fund, is an example of the type of fund that would be affected by the proposed rule amendment, and was specifically cited in the original rulemaking petition filed by the National Futures Association (the "Petition").[1]

We would like to comment on three issues that were raised at the roundtable: (1) the threshold and marketing restriction that would presumably define the scope of which funds will be covered by the Rule; (2) how to accomplish harmonization in an effective and efficient manner, and (3) the use of wholly-owned Controlled Foreign Corporations.

1) Threshold and Marketing Restriction

We suggest that the Rule be amended so as to include funds that would commonly be classified as "commodity funds" or "managed futures funds", but to exclude funds that would usually be classified as bond funds or equity funds, even when they make extensive use of financial futures and/or swaps to attain their objectives.

[1] Petition of the National Futures Association, Pursuant to Rule 13.2, to the U.S. Commodity Futures Trading Commission to Amend Rule 4.5, 75 Fed. Reg. 56997 (Sept. 17, 2010).

We suggest that the following quantitative and qualitative *indicia* be used to determine whether a fund would be covered by the rule (the "Bucket"). A fund would be in the Bucket if:

- the margin related to financial futures and swaps exceeds 10% of the fund's net asset value (setting this higher threshold would allow most bond and equity funds that utilize futures and swaps to fall outside of the Bucket);
- the margin related to non-financial futures exceeds 5% of the fund's net asset value;
- the fund is marketed as a "commodity" or "managed futures" fund, regardless of its name;[2]
- the fund makes use of a wholly-owned Controlled Foreign Corporation;
- the notional value of its long positions across all futures and swaps contracts exceeds 100% of the fund's NAV;
- the fund has a net short position in one or more of the underlying instruments.

For purposes of determining whether a fund has a net short position in a particular instrument, the underlying individual securities related to the financial instrument would be included in the calculation.[3] For example:

- A fund that is short corn futures (netting different maturity dates) would be deemed to have a net short position in that instrument.
- A fund with 5% of its NAV invested in Japanese equities and a 4% short position based on a Nikkei Index futures contract (calculated using the contract's notional value) would be deemed to have a 1% net long position.

We suggest that whether a fund is "active" or "passive" should not be used in any determination related to whether a fund belongs in the Bucket. Active and passive funds are close substitutes and compete directly with each other, and we see no reason why they should be regulated differently.

2) Harmonization of Disclosure Requirements

We suggest that the most effective way to accomplish harmonization is to provide investors with both an SEC prospectus and a CFTC disclosure document, collated into a single wrapper, with cross-references where appropriate (e.g., the fee table in one document would cross-reference the fee table in the other document).

We believe there are three key reasons why this approach would make sense:

- Comparability. One of the key objectives of these disclosure documents is to enable the investor to compare competitive products on an equal footing. For example, in the case of fee comparisons, this cannot be accomplished by creating a hybrid fee table, since such a table would not allow an "apples-to-apples" comparison to either commodity pools or mutual funds.[4]

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[2] Some of the qualitative, although not necessarily conclusive, *indicia* as to whether a fund belongs in the Bucket would include classification by industry data services such as Morningstar or Lipper, and the choice of benchmark or peer group for performance reporting.

[3] This is relevant for the determination of a "net short position" in the last bullet of the previous paragraph.

[4] This is particularly important in the case of managed futures. Both mutual funds and commodity pools of this type currently compete head-to-head. An investor comparing the fees of a managed futures commodity pool and a managed futures mutual fund would be able to make an "apples-to-apples" comparison by comparing the respective

- Ongoing Staff Review Process. If a harmonized common disclosure document were to be developed, it would require CFTC staff to become familiar with all the rules pertaining to SEC disclosures and vice versa. This problem would be exacerbated by the fact that each agency needs to be able to modify its disclosure requirements without having to take into account the ripple-effects on the harmonized document. At a minimum, it should be made clear which sections of a combined document are under the purview of which agency. Sections requiring joint review should be avoided if at all possible. A clear division of responsibilities will also speed up the review process, allowing each reviewing agency to operate independently of the other.

- Speed and Cost of Implementation. Under this approach, it would be possible to reduce the amount of time and effort required by both CFTC and SEC staff to achieve harmonization. In light of the other pressing issues (Dodd-Frank), as well as the fact that relatively few funds will be affected by the Rule,[5] we believe that an approach that accomplishes the key objectives of the proposal without taking up an inordinate amount of staff resources would be desirable.

3) Use of Controlled Foreign Corporations

By now it has been widely discussed that the original purpose of Controlled Foreign Corporations ("CFCs") has been to avoid adverse tax consequences, and not to evade the rules regulating mutual funds.

On a voluntary basis, the vast majority of mutual funds that employ a CFC structure operate their fund and the underlying CFC in a manner that is fully compliant with all applicable mutual fund disclosure and transparency rules:

- Individual holdings are fully disclosed on a quarterly basis, both at the fund and the subsidiary level (in some cases separately, in some cases in a consolidated form).
- Fees at both the fund and CFC level are fully disclosed, and are included in the expense ratio shown in the Fees and Expense table of the prospectus.
- Funds comply with applicable leverage rules both at the fund and CFC level.[6]
- The fund's board supervises the CFC: it selects service providers, monitors compliance, receives regular reports, and approves the investment advisory agreement.

In contrast, there are only a small number of funds[7] that make use of the CFC structure in a way that would not be permitted if they were to be treated as a mutual fund under the Investment Company Act:

CFTC disclosure documents. At the same time, an investor trying to compare a managed futures mutual fund with, say, an equity mutual fund would be able to compare their fees based on similarly comparable prospectuses.

[5] As of June 30, 2011, there are 24 Commodities funds and 17 Managed Futures funds, based on Morningstar categories.

[6] Compliance with the leverage restrictions of the Investment Company Act of 1940 has been stipulated in all the private letter rulings relating to the CFCs issued by the IRS with which we are familiar.

[7] We are aware of only two such funds: Mutual Hedge Frontier Legends Fund (MHFAX), and Altegris Managed Futures Strategy Fund (MFTAX).

- Rather than showing individual holdings in their annual and quarterly reports, these funds only disclose aggregate investments in "Systematic Trading Companies," which in turn are managed by various CTAs.
- The funds do not include the expenses of the underlying sub-advisors or CTAs in the "Acquired Fund Fees" line item of a normal mutual fund's expense ratio.[8]
- The sub-advisors or CTAs of these funds use 2+20% type performance fees. The use of such performance fees is prohibited among mutual funds. For mutual funds, only fulcrum-style performance fees are allowed.[9]

While the first two issues enumerated in the prior paragraph can easily be remedied by making such disclosure mandatory, the third issue is more fundamental, in that these funds have used the CFC structure to achieve a fee structure that would not be allowed for a typical mutual fund.

We strongly favor action by both the SEC and/or CFTC to ensure that the CFC structure is not and cannot be used to circumvent normal mutual fund rules and disclosure requirements. We would suggest that any CFC should be required to follow substantially all the rules that would normally apply to a mutual fund.[10]

Conclusion

We appreciate the opportunity to provide comments to the staff and Commission on this important regulatory initiative. The three issues we have raised are meant to help contribute to the debate as to the scope of the proposed Rule, the best way to accomplish harmonization, and ways to tighten disclosure and other rules pertaining to wholly-owned CFCs.

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If you would like more information about any of the topics discussed in this letter, or if we may be of assistance in any other way, please feel free to contact us. I can be reached at 203-742-3880, or you can reach Brendan Kalb at 203-742-3618.

Sincerely,

Marco Hanig
President of AQR Funds

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[8] We believe this is based on a determination that a Controlled Foreign Corporation is not an "acquired fund" but rather a corporate entity.

[9] Fulcrum fees are symmetrical around a "fulcrum" point. E.g. a fund may charge 0.8% plus or minus 0.2% depending on whether it has over or under-performed its benchmark over some specified prior period.

[10] Potential ways in which rules for CFCs may need to be different than those pertaining to mutual funds would include those pertaining to their offshore legal structure, and potentially other ways as well (e.g. Rule 12d1 of the Investment Company Act).

cc: The Honorable Gary Gensler, Chairman
The Honorable Michael V. Dunn, Commissioner
The Honorable Jill E. Sommers, Commissioner
The Honorable Bart Chilton, Commissioner
The Honorable Scott D. O'Malia, Commissioner

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