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COMMENT

Jean A. Webb, Secretary  
Commodity Futures Trading Commission  
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1155 21<sup>st</sup> Street, N.W.  
Washington, D.C. 20581

RE: Advance Notice of Proposed Rulemaking ("ANPR") on  
Commodity Pool Operator and Commodity Trading  
Advisor Registration Exemptions (67 Federal Register  
68785, November 13, 2002)

Dear Ms. Webb:

The Committee on Regulation of Futures and Derivative Instruments (the "Committee") of the American Bar Association submits this comment letter in response to the request of the Commodity Futures Trading Commission ("Commission") for comments on proposals by the National Futures Association ("NFA") and the Managed Funds Association ("MFA") for certain relief from the Commission's registration requirements for commodity pool operators ("CPOs") and commodity trading advisors ("CTAs") as set forth in the ANPR.

The Committee consists of attorneys who regularly advise operators of collective investment vehicles and appreciates this opportunity to express its views on the proposals. The Committee generally supports the exemptive relief contemplated by both proposals. Each would serve to some degree to reduce both legal uncertainty and regulatory costs for those who operate collective investment vehicles in which all of the investors possess a degree of financial sophistication which renders the protections provided by government regulation less relevant.

The comments expressed in this letter represent the views of the Committee only and have not been approved by the American Bar Association's House of Delegates or Board of Governors and therefore do not represent the official position of the Association. In addition, this letter does not represent the official position of the ABA Section of Business Law, nor does it necessarily reflect the views of all members of the Committee.

## THE PROPOSALS

The MFA proposes to add a new CPO registration exemption ("Proposed Rule 4.9") covering operators of collective investment vehicles, the interests of which are exempt from registration under the Securities Act of 1933 and are offered without marketing to the public in the United States. Proposed Rule 4.9 would enable the operators of such pooled investment vehicles to claim such exemption by filing with the Commission a notice of eligibility. The person operating such an eligible pool must reasonably believe that at the time of investment all individual investors are qualified eligible participants ("QEP") as defined by the Commission and that all entity investors are either accredited investors as defined in 17 C.F.R. 230.501(a)(1)-(3), (7) and (8) or QEPs. Any such pool operator would remain subject to the anti-fraud and anti-manipulation provisions of the Commodity Exchange Act and would be required to deliver to the participants in each eligible pool an annual financial statement certified by an independent public accountant and prepared in accordance with generally accepted accounting principles. Two copies of such financial statement must also be filed with the Commission. Each such operator must also undertake in its notice of eligibility that it will submit to special calls by the Commission to demonstrate compliance with Proposed Rule 4.9.

The NFA's proposal would amend Commission Rule 4.13 to provide for exemptive relief similar to that in the MFA proposal but would further limit the relief to only those persons who operate collective investment vehicles which use exchange-traded commodity interest contracts for bona fide hedging purposes and non-hedging use of such contracts, if such trading is solely incidental to its other trading activity and the margin and premiums required to establish such positions does not exceed five percent of the liquidation value of the pool's portfolio. NFA Proposed Rule 4.13(a)(3)(i). The NFA proposal also contains certain recordkeeping and disclosure requirements.

Both proposals would provide for special calls by the Commission in order to demonstrate compliance with the exemption.

The MFA proposal differs from that of the NFA in at least three primary respects. First, Proposed Rule 4.9 would not place a limitation on the extent of use of exchange-traded commodity interest contracts by eligible operators. Second, the MFA proposal would not require that use of exchange-traded commodity interest contracts be solely for bona fide hedging purposes. Third, the MFA proposal would require the higher QEP standard for individual investors, instead of the accredited investor standard. The NFA proposal also calls for certain mandatory language concerning the exemption to be included in disclosures to prospective pool participants and a requirement that the operator maintain books and records not found in the MFA proposal.

The Committee urges the Commission to provide the exemptive relief contemplated by the MFA proposal, but with certain modifications drawn from the proposal of the NFA.

## **CRITERIA FOR EXEMPTION**

The MFA proposal establishes as a criteria for exemption that all investors in an eligible pool be either QEPs, in the case of individuals, or accredited investors, in the case of entities. Like the NFA proposal, MFA would require that eligible pools not be marketed to the general public. Unlike the NFA proposal, MFA's Proposed Rule 4.9 does not condition eligibility for exemption on any limitation on the use of commodity interest contracts, either numerical or purposive. By blending the accredited investor standard for non-individual investors with the more restrictive QEP standard for individual investors, Proposed Rule 4.9 limits participation in eligible pooled investment vehicles to those investors who possess a degree of financial sophistication sufficient to evaluate the investment on its merits. Such evaluation would necessarily entail an assessment of the risks of the investment vehicle, including the extent to which those risks would be affected by trading of exchange listed commodity interests for hedging or non-hedging use. There simply is no overriding public protection or regulatory policy to be served by imposing the costs on otherwise eligible pools for determining whether a particular transaction or strategy is bona fide hedging. Likewise, there is no significant regulatory purpose to be served by imposing on otherwise eligible pools the burden of constantly measuring the extent of commodity interest trading as a function of the liquidating value of the pool in order to remain eligible for the exemption. This may be especially true for pools that are traded by several advisors who may have different trading strategies and for fund of funds.

Thus, the Committee supports the MFA proposal's use of the accredited investor standard for non-individual investors and the QEP standard for individual investors. Furthermore, the Committee suggests that the Commission not detract from the simplicity and clarity of the MFA proposal by imposing subjective or numerical limitations on the use or extent of exchange-traded commodity interest contracts, which would unduly complicate issues of continuing eligibility of a pool for exemptive relief and detract from the goal of regulatory certainty.

## **OPERATION OF THE EXEMPTION**

Both proposals provide for filing with the Commission by persons who are eligible for exemption. Such notice would provide the Commission with information as to the extent of use of such vehicles and a mechanism for assessing the continuing eligibility of such pools for the exemption.

The NFA proposal contains language which appears to withhold any exemptive relief from those who are registered as CPOs (subsections (a)(3)(i) and (d) of the NFA's proposed amendment to Rule 4.13), whereas the MFA proposal would allow registered CPOs to operate pooled investment vehicles in which all investors are financially sophisticated under the definitions of accredited investors or QEPs. The Committee is of the view that the MFA's approach, which would allow even those pool operators who register as CPOs to operate exempt pools as well, does not unfairly burden that category of Commission registrant and thus is preferable. The NFA proposal could lead to the less desirable consequence of de-registration for some CPOs.

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The Committee also believes that the annual certified financial statement required by the MFA's proposal to be delivered to each pool participant and to the Commission is sufficient to protect the public interest, given the types of investors that would be able to participate in exempt pools. For purposes of regulatory consistency, and to ensure that Commission enforcement efforts are not hindered, the Committee believes that the provision found in the NFA proposal that would require that an exempt pool's books and records be kept for five years, and be readily accessible to the Commission is also appropriate.

#### SUMMARY

The Committee therefore supports the MFA proposal, with amendments consistent with the foregoing discussion.

Respectfully submitted,

Joseph P. Collins, Chairman

A handwritten signature in black ink that reads "Joseph P. Collins by msh". The signature is written in a cursive, slightly slanted style.