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COMMENT

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January 23, 2003

Via E-mail and Facsimile

Ms. Jean A. Webb,
Office of the Secretariat,
Commodity Futures Trading Commission,
Three Lafayette Center,
1155 21st Street, N.W.,
Washington, DC 20581.

Re: Advance Notice of Proposed Rulemaking on Commodity Pool Operator and Commodity Trading Advisor Registration Exemptions (File No. 02-014)

Dear Ms. Webb:

We are pleased to submit this letter in response to the request of the Commodity Futures Trading Commission (the "Commission") for comments on the Commission's proposed exemptions from the registration requirements applicable to commodity pool operators ("CPOs") and commodity trading advisors ("CTAs") discussed in its Advance Notice of Proposed Rulemaking (the "Notice").[1] The Notice outlined three specific forms of CPO and CTA registration relief: a proposal by the National Futures Association ("NFA") for additional CPO and CTA registration exemptions (the "NFA Proposed Rule"); a proposal by the Managed Funds Association ("MFA") for an additional CPO registration exemption ("Proposed Rule 4.9"); and the Commission's issuance of temporary no-action relief from the CPO and CTA registration requirements (the "No-Action Relief") (collectively, the "Proposed Rules"). The Commission has solicited public comments on the Proposed Rules and on specific issues related to these proposals. This letter sets forth general comments on the Proposed Rules and provides specific comments on select aspects of the individual proposals.

[1] 67 Fed. Reg. 68,785 (Nov. 13, 2002).

I. GENERAL COMMENTS

We support the Commission's adoption of the NFA and MFA proposals and the permanent adoption of the No-Action Relief. Collectively, the Proposed Rules provide different types of market participants with diverse opportunities to trade exchange-traded futures and options on futures (together, "Futures") without registering as CPOs. Taken together, the Proposed Rules effectively accommodate a wide range of private investment vehicles that desire to invest in Futures, ranging from funds that intend to purchase de minimis amounts of Futures to funds that plan to trade Futures to establish significant nonhedging positions.

Our clients include onshore and offshore private investment funds, mutual funds and closed-end investment companies registered under the Investment Company Act of 1940 and other collective investment vehicles, many of which are marketed only to highly sophisticated and/or experienced investors. We also represent the advisors of such vehicles. In our experience, many such clients have refrained from engaging in Futures trading because of the perceived burden of CPO registration. In particular, clients who have been interested in engaging in a de minimis amount of Futures trading have chosen not to trade Futures in order to avoid the CPO registration requirements. Likewise, advisors of such vehicles frequently wish to avoid CTA registration. Accordingly, we believe that the adoption of the Proposed Rules will encourage many collective investment funds to use the Futures markets to more effectively implement their investment and risk management strategies, which should result in increased product volume and liquidity in these markets.

We believe that each of the Proposed Rules strikes an appropriate balance between liberalizing the use of Futures by certain pool operators and ensuring the adequate protection of investors in those pools. The Proposed Rules achieve this balance by restricting the types of investors who may participate in pools run by operators exempt from CPO registration and/or limiting the extent to which such pools may trade Futures. The investor restrictions in the Proposed Rules effectively ensure that all participants in a collective investment fund whose operator claims registration relief under any of the Proposed Rules are sufficiently sophisticated and knowledgeable to obviate the need for the additional protections provided by CPO registration. The same considerations support the proposed relief from CTA registration.

II. SPECIFIC COMMENTS

1. The NFA Proposed Rule should be available on a pool-by-pool basis.

Both the MFA's Proposed Rule 4.9 and the No-Action Relief allow a CPO to claim exemption from registration on a pool-by-pool basis. Assessing a CPO's eligibility for registration relief in relation to each of its investment pools reflects the fact

that CPOs often operate multiple collective investment pools, which may have varying investor qualifications. Allowing CPOs to claim relief on a pool-by-pool basis will enable CPOs to use Futures in exempt pools while simultaneously ensuring that investors in nonexempt pools continue to benefit from the additional investor protections that CPO registration provides. Accordingly, we encourage the Commission to make the NFA Proposed Rule available to CPOs on a pool-by-pool basis.

2. A CTA that advises an investment pool whose operator claims relief from CPO registration under Proposed Rule 4.9 should be allowed to rely on a corresponding CTA registration exemption.

Proposed Rule 4.9 does not include any relief from registration for CTAs. Many CTAs that advise pools that would be able to claim registration relief under Proposed Rule 4.9 if it were adopted would be able to take advantage of Rule 4.7, which provides disclosure and recordkeeping relief to CTAs who direct the accounts of qualified eligible persons ("QEPs"). However, it is possible that a pool that qualifies for CPO registration relief under Proposed Rule 4.9 would not qualify as a QEP. This would preclude the pool's advisor from claiming any form of CTA registration relief. We encourage the Commission to extend the relief available to CTAs under Rule 4.7 to those CTAs that advise pools claiming relief under the Proposed Rule 4.9 exemption on an account-by-account basis.

3. The operator of an Investor Fund who meets the investment limitations of either the No-Action Relief or NFA Proposed Rule should be able to invest in Investee Funds that meet the Futures investment limitations of the respective form of relief claimed by the Investor Fund operator, whether or not the Investee Fund's operator itself claims such relief.

The No-Action Relief provides that the operator of a fund-of-funds ("Investor Fund") that indirectly trades Futures through participation in one or more funds that directly trades Futures (each, an "Investee Fund") could claim relief from registration if the Investee Funds themselves have claimed the No-Action Relief.[2] We strongly support this relief for Investor Funds, and we suggest that this relief should be extended to Investor Funds that participate in Investee Funds whose operators, although not claiming the No-Action Relief, represent to the Investor Fund that such Investee Fund meets and will at all times continue to meet the Futures investment limitations of the No-Action Relief. Investor Funds should be able to rely on such a representation without being required to have actual knowledge of the Investee Funds' underlying positions. Thus, under this approach, an Investor Fund could invest in a combination of Investee Funds that have claimed the No-Action Relief and those that represent to the Investor

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2 *See* footnote 15 of the Notice.

Fund that they meet the required Futures investment limitation. This relief would address the situation where the operator of an Investee Fund is registered with the Commission as a CPO, but its Futures trading strategies meet the investment limitations in the No-Action Relief.

We also suggest that an analogous form of relief be extended to operators whose Investor Funds qualify for exemption from registration under the NFA Proposed Rule. Investor Funds eligible for CPO registration relief under the NFA Proposed Rule likewise should be able to invest in pools that either have claimed relief under the NFA Proposed Rule or represent to the Investor Fund that such pool meets and will at all times continue to meet the Futures investment limitation criteria of the NFA Proposed Rule. Investor Funds should be able to rely on such a representation without being required to have actual knowledge of the Investee Funds' underlying positions.

Of course, if an Investor Fund claiming relief in either of these situations directly trades Futures, the portion of the Investor Fund that directly trades Futures could not exceed the limits in the applicable rule.

4. The Commission should address non-hedging activity limitation calculations for Rule 4.5-eligible funds that invest in Investee Funds.

We believe that there are funds whose operators are exempt from CPO registration under Rule 4.5 (each, a "Rule 4.5 Fund") that are interested in investing in funds that will qualify for exemption under the Proposed Rules, and we request that the Commission address the opportunity for such investments by Rule 4.5 Funds. Specifically, we ask that the Commission provide guidance regarding the calculation of Rule 4.5's limitations on non-hedging activity (as recently proposed to be amended, and as effectively currently modified by the Commission's no-action position published in the Federal Register on October 28, 2002)[3] where a Rule 4.5 Fund invests in Investee Funds, recognizing that the operators of Rule 4.5 Funds are otherwise regulated and that a Rule 4.5 Fund's risk of loss will be capped by the amount invested in an Investee Fund.

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[3] 67 Fed. Reg. 65,743 (Oct. 28, 2002).

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We appreciate this opportunity to comment on the Commission's Proposed Rules and would be happy to discuss any questions the Commission may have with respect to this letter. Any such questions may be directed to Kenneth M. Raisler (212-558-4675).

Very truly yours,

Sullivan & Cromwell LLP

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