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SEWARD & KISSEL LLP
ONE BATTERY PARK PLAZA
NEW YORK, NEW YORK 10004

TELEPHONE: (212) 574-1200
FACSIMILE: (212) 480-8421
WWW.SEWKIS.COM

1200 G STREET, N.W.
WASHINGTON, D.C. 20005
TELEPHONE: (202) 737-8833
FACSIMILE: (202) 737-5184

WRITER'S DIRECT DIAL
212-574-1225

April 30, 2003

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Via Electronic Mail: secretary@cftc.gov

Jean A. Webb, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Additional Registration and Other Regulatory Relief for Commodity Pool Operators and Commodity Trading Advisors

Dear Ms. Webb:

We are writing in response to the Commission's specific requests for comment on certain issues addressed in the Additional Registration and Other Regulatory Relief for Commodity Pool Operators ("CPOs") and Commodity Trading Advisors ("CTAs") issued by the Commission on March 12, 2003 (the "Regulatory Relief"). Specifically, we recommend that the Commission:

- revise Proposed Rule 4.13(a)(4) so that the manager of a fund may claim the exemption if fund participants who are individuals meet the definition of "qualified eligible person" under any section of CFTC Rule 4.7 (including individuals who meet the portfolio requirement, but are not "qualified purchasers");

- revise Proposed Rule 4.13(a)(3) so that the manager of a fund may claim the exemption if the fund commits five percent or less of the liquidation value of the fund's portfolio to establish commodity interest trading positions (the "Five Percent Test"), rather than two percent, as proposed;

- provide an exemption from registration for a fund-of-funds manager if the fund-of-funds itself, indirectly and on an aggregate basis, meets the trading limitations under Proposed Rule 4.13(a)(3); and

- revise Rule 4.22 to enable a CPO to distribute Annual Reports to investors electronically upon appropriate consent and disclosure.

Introduction

Seward & Kissel represents numerous private investment partnerships and related offshore funds managed by U.S. investment managers. As we stated in our January 10, 2003 letter commenting on the Advanced Notice of Proposed Rulemaking ("ANPR"), many of these managers have resorted to alternate, less efficient trading techniques to hedge their funds in order to avoid registration with the CFTC.

We continue to believe that the proposed exemptions from registration will encourage such managers to use commodity futures and will expand the availability of futures (including single stock futures) to a greater number of qualified investors.

Proposed Rule 4.13(a)(4) and Qualified Eligible Persons

Proposed Rule 4.13(a)(4) would provide an exemption from CPO registration to managers who limit investors in a fund to (i) non-natural person participants who are either qualified eligible persons ("QEPs") or accredited investors[1] and (ii) natural persons who are QEPs as defined in CFTC Rule 4.7(a)(2) (which does not include natural persons who meet the $2 million "portfolio requirement"[2] but requires them instead to maintain $5 million in investments). By limiting the QEP definition for natural persons to the higher "qualified purchaser"[3] standard of $5 million in investments under the Investment Company Act of 1940, as amended, as adopted in Rule 4.7(a)(2), the Commission has eliminated any individual who meets only the $2 million "portfolio requirement" of Rule 4.7(a)(3).

We believe that the appropriate standard for individual investors under this exemption is the QEP standard as set forth in the portfolio requirement of Rule 4.7(a)(3). Proposed Rule 4.13(a)(4) is based on a proposal submitted by the Managed Funds Association (the "MFA Proposal"); however, the MFA Proposal distinguished between the qualifications for natural persons (who would be required to meet the $2 million portfolio test) and the qualifications for non-natural persons (who would be required to meet the $5 million "accredited" test). The Commission has elected not to make that distinction and has effectively proposed that both natural persons and entities, generally, have $5 million, either in "investments" (for individuals) or net worth (for entities).

We believe that the QEP standard adopted under CFTC Rule 4.7 is an objective financial sophistication standard, appropriate for natural persons, and that such persons have the knowledge and experience necessary to understand and accept the risks of an investment in a fund that utilizes futures. When the Commission adopted the $2 million portfolio requirement as the level of qualification for investors in 4.7 funds (whose managers are not required to provide all of the disclosure required under Commission regulations, it presumably believed that $2 million in investments was the appropriate qualification standard. To now raise the qualification standards to $5 million for individual investors seems to restrict the relief needlessly by excluding funds that have only sophisticated, accredited investors if certain of their individual investors do not have $5 million or more in investments, even though all investors maintain investment portfolios worth more than $2 million.

Proposed Rule 4.13(a)(3) and the "Two Percent Test"

Proposed Rule 4.13(a)(3) would provide an exemption from CPO registration if the fund manager represents that (i) the participants in the fund are all "accredited investors" and (ii) the pool will engage in a limited amount of commodity interest trading, whether entered into for bona fide hedging purposes or otherwise, by either:

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[1] To be considered "accredited" under Rule 501(a) of the Securities Act of 1933, as amended, a natural person generally must have a net worth in excess of $1 million or an annual income in excess of $200,000 a year from the two most recent years (or $300,000 with his or her spouse), while non-natural persons must have net assets of at least $5 million.

[2] Under CFTC Rule 4.7 (a)(3), an investor must be accredited and must maintain a portfolio of $2 million in securities to be deemed a QEP (the "portfolio requirement").

[3] Section 2(a)(51) under the Investment Company Act requires that an individual own not less than $5,000,000 in investments to be deemed a qualified purchaser.

- committing 2% or less of the liquidation value of the pool's portfolio to establish commodity interest trading positions, (the "Two Percent Test") or

- limiting the aggregate net notional value of the pool's commodity interest trading to no more than 50% of the pool's liquidation value (the "Notional Value Test").

The Proposed Rule expands the exemptive relief set forth in the ANPR by adding the Two Percent Test to the Notional Value Test and provides greater flexibility for managers that engage in a limited amount of commodity trading to fall within the relief of the ANPR. However, unlike the proposal submitted by the National Futures Association (the "NFA Proposal"), which recommended the Five Percent Test, the Commission has reduced the amount that could be committed to establish commodity positions from five percent to two percent of the liquidation value of the pool's portfolio.

We believe that the Five Percent Test is the more appropriate margin limit for funds utilizing futures in a *de minimis* manner. As discussed by the Commission in the "Exclusion for Certain Otherwise Regulated Persons From the Definition of the Term 'Commodity Pool Operator'" issued October 28, 2002 as the first amendment to Rule 4.5 (the "Exclusion for CPOs"), "margin levels for certain stock index futures have come to significantly exceed 5 percent of contract value, thereby limiting the use of such contracts in non-hedging strategies to a much greater extent than other types of contracts with lower margins."[4] In addition, margins for security futures products are generally 20 percent of contract value. The Commission commented in the Exclusion for CPOs that it had already received expressions of concern from the industry that the 5 percent limit may not be high enough, at least with respect to Rule 4.5, which is the stated rationale for adding the Notional Value Test to Rule 4.5.

If the intent of Proposed Rule 4.13(a)(3) is to expand the availability of futures to managers without requiring these managers to register, it seems incongruous to adopt a percentage limit which is lower than the limit that the industry has already indicated to be unacceptable, especially given the fact that margin requirements are rising. As the exemption is intended to apply to funds that are primarily securities funds for which futures are a secondary trading strategy, the Five Percent Test is a more appropriate limit for meeting the *de minimis* test than the proposed rule.

Use of Futures

We also believe that the Five Percent Test and the Notional Value Test should apply only to non-hedging positions and that there should be no trading limit on positions established for bona fide hedging purposes. Although a *de minimis* test may be more difficult to compute if hedged and non-hedged positions are combined, a fund that uses commodities solely for bona fide hedging purposes poses less overall risk to the fund's portfolio; accordingly, fund managers using futures only for hedging should not be restricted as to how much margin they can use with respect to the fund. Requiring such managers to register with the Commission should they exceed a particular trading limit could encourage them to use other, unregulated and more risky instruments for hedging purposes. We recommend that the exemption from registration for fund managers who use commodities only for bona fide hedging should apply to any pool operator, regardless of whether or not the investors are "accredited".

Accredited Investor Standard

As we recommended in our January 10th letter to the Commission, we continue to believe that the new exemption under Proposed Rule 4.13(a)(3) should contain a provision permitting a fund to admit a

[4] See Exclusion for Certain Otherwise Regulated Persons from the Definition of the Term "Commodity Pool Operator" issued October 28, 2002.

limited number of unaccredited investors, if such investors are otherwise qualified or sophisticated[5]. This would be useful to permit investments by qualified investors who do not technically meet the definition of an accredited investor, including:

- individuals who are "knowledgeable employees" under Section 2(a)(51) of the Investment Company Act of 1940, as amended[6];
- investments by trusts formed by accredited investors for the benefit of their family members, when the grantors and/or trustees of the trust are accredited, but the trust itself is not funded with an amount that would enable it to be an "accredited investor".

Funds-of-Funds

We commend the Commission for providing No-Action Relief from registration for fund-of-funds managers. Under the Commission's historical position, the manager of a fund-of-funds ("investor fund") who invests in commodity pools must register as a CPO. In fact, the manager of an investor fund that invests in just one underlying commodity pool is required to register. Many such managers refuse to invest in any commodity pools so as to avoid registration, which may act to disadvantage their investors. Since the operators of funds-of-funds are not directly transacting in commodity futures, no useful purpose seems to be served by requiring them to register.

The No-Action Relief for fund-of-funds managers as expanded in the March 12 Regulatory Relief provides that a manager of an investor fund can rely on the No-Action Relief if (i) the managers of all the underlying funds that are commodity pools in which the investor fund invests have also claimed the No-Action Relief, or if the underlying managers are registered CPOs and represent that they will operate their funds in accordance with the terms of the No-Action Relief and (ii) the portion of the investor fund that trades futures directly does not exceed the Notional Value Test or the Two Percent Test. We recommend that the Commission incorporate these provisions in a specific exemption from registration for fund-of-funds managers (except, as discussed above, incorporating the Five Percent Test instead of the Two Percent Test).

In addition, as suggested in our previous letter, we continue to recommend that the manager of a fund-of-funds be exempt from CPO registration if the fund-of-funds itself meets the trading limitations under Proposed Rule 4.13(a)(3) indirectly and on an aggregate basis, based on its pro rata portion of the commodity interests of the underlying funds.

For example, a fund-of-funds might invest 25% of its assets in each of the following four underlying funds:

Underlying Fund	Notional Value of Commodity Interests (expressed as a percentage of the liquidation value of the Underlying Fund)
Fund A	0%
Fund B	0%

[5] We note that Rule 506 of Regulation D under the Securities Act of 1933, as amended, contains a provision permitting an issuer to admit up to 35 unaccredited (but sophisticated) investors.

[6] See Commission Rule 4.7(a)(2), which provides an exemption from the maintenance of a $2 million portfolio for knowledgeable employees.

Fund C	10%
Fund D	60%

In this example, assuming the manager of Fund D also could not meet the Two Percent Test, it would not be able to meet either of the trading limits under Proposed Rule 4.13(a)(3); nevertheless, the aggregate notional value of the commodity interests in the fund-of-funds would be 17.5%, far below the Notional Value Test provided in Proposed Rule 4.13(a)(3) with respect to managers who invest directly in futures. We believe that a manager of a fund-of-funds should be given the same flexibility as the manager of a fund that invests directly in commodities.

Electronic Distribution of Annual Reports

The Commission has proposed certain criteria pursuant to which a CPO may electronically distribute account statements to fund participants and is requesting comment on the criteria under which a CPO may electronically distribute the Annual Report. We believe that the disclosure and consent criteria applicable to electronic distribution of the account statements should be amended to also include electronic distribution of the Annual Report. The certification that is required to be included with the Report could either be (i) scanned and attached to the Report or (ii) included as a legend at the beginning of the Report. In either case, the CPO would be required to keep a manually signed copy of the original certification in its offices.

Conclusion

We commend the Commission for the expanded No-Action Relief and the proposed exemptions from registration for managers who utilize futures in an incidental manner and believe that their adoption will permit and encourage more fund managers to consider utilizing futures as another investment vehicle in their funds.

If you would like to discuss any of our recommendations, or if you have any questions, please feel free to call either Jack Rigney (212-574-1254) or Billie Cook (212-574-1225).

Very truly yours,

Jack Rigney

Billie Cook

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