New York State Bar Association

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June 16, 2000

VIA FACSIMILE AND FIRST CLASS MAIL

Jean A. Webb, Secretary
Commodity Futures and Trading Commission
Three Lafayette Centre
1155 - 21st Street, N.W.
Washington, D.C. 20581

Re: Proposed Rule 4.27:
Public Reporting by Operators of Certain Large Commodity Pools

Dear Ms. Webb:

The Committee on Futures and Derivatives Law of the New York State Bar Association (the "Committee") respectfully submits this comment letter to the Commodity Futures Trading Commission (the "Commission") in response to its request for comments concerning its proposed Rule 4.27 (the "Proposed Rule"), which was published in the Federal Register on April 17, 2000 (65 F.R. 20395). The Bar Association of the State of New York is comprised of approximately 60,000 attorneys licensed to practice in New York, and the Committee is comprised of approximately 50 attorneys in private practice, government, corporations and academia. They represent or have an interest in commodity and derivatives industry institutions and individuals, including futures commission merchants, floor brokers, floor traders, customers, commodity pool operators, commodity trading advisors, banks, investment banks, and commercial operators in the cash and futures business. The views expressed in this comment letter are those of the Committee and should not be imputed to the Association as a whole.

For the reasons discussed below, the Committee believes that the Proposed Rule does not achieve its stated objective and may result in undesirable consequences for registrants, market

participants and the Commission itself. The Committee therefore opposes the adoption of the Proposed Rule, especially in view of pending Congressional examination of the issue and recently implemented private and government initiatives.

The Proposed Rule does not achieve its stated objective.

In proposing new Rule 4.27, the Commission states that it seeks to implement the recommendation of The President's Working Group on Financial Markets ("PWG") that "more frequent and meaningful information on hedge funds should be made public". The Commission asserts in its proposal that "public disclosure of the information collected under this rule should help other market participants to make more informed judgments and to more effectively exercise market discipline."

The Committee does not believe that the Proposed Rule will provide meaningful information to market participants. Rather, the Committee believes that the information the Commission proposes to collect will be incomplete and stale upon publication and therefore will not provide market participants with useful information which would permit them to make informed judgments about reporting persons (as defined in the Proposed Rule). Given the rapidity with which such entities change their positions in response to market events, the summary type of quarterly information that the Commission would publish under the Proposed Rule could have little or no relation to the actual exposures of a reporting person upon publication and may serve to mislead rather than usefully inform market participants.

Unfortunately, it is not possible to overcome this defect in the Proposed Rule simply by collecting more timely or detailed information because public disclosure of such information would reveal or compromise what could be proprietary information about a reporting person's positions or strategies. The Commission, the PWG and members of Congress have recognized that it would be inappropriate, if not unlawful, to release publicly information that is proprietary in nature.[1] Indeed Section 8(a)(1) of the Commodity Exchange Act provides that the Commission "may not publish data and information that would separately disclose the business transactions or market positions of any person[.]" Congressman Baker, who introduced pending legislation to require the public disclosure of information very similar to that which the Proposed Rule would collect and publish, has articulated the problem presented by the public disclosure of such information: "timely released" information would be highly proprietary and business sensitive in nature, while information "that is not timely release and is retrospective in its view is of little value . . . ."[2]

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[1] See the Proposed Rule, note 20; PWG Report at 32-33; Opening Statement of Rep. Richard Baker Before the House Banking and Financial Services Committee Subcommittee on Capital Markets, Securities and Government Sponsored Enterprises, March 16, 2000.

[2] Although the public would not be entitled to sensitive or proprietary information, parties that might desire such information for a legitimate purpose, such as the credit department of a counterparty, are not prevented from seeking it directly from a pool operator (where, for example, appropriate confidentiality safeguards are established to guard against its unauthorized use or public release).

The Proposed Rule may have harmful consequences.

Given the continuing debate concerning the utility of the information that would be published under the Proposed Rule, the Committee believes it would be inappropriate for the Commission to promulgate rules that may be interpreted as validating such information as a sufficient basis for making an informed judgment about reporting persons. The Committee also believes that, by adopting the Proposed Rule, the Commission risks being perceived by market participants as actively overseeing the hedge fund industry, which may have the counterproductive effect of subduing creditor and investor vigilance. Although the Commission attempts in its proposal to circumscribe its role to serving as "a conduit for transmitting this information to the public," the Committee is not convinced that the Commission can effectively disclaim responsibility for analyzing and monitoring such information once it has promulgated rules providing for the Commission's collection of it. Rather, the Committee believes that the public is likely to presume that a regulator charged with fostering market integrity will review and study the data supplied to it in an effort to minimize systemic risk.

In addition, the Committee believes that the public release of such information could expose reporting persons to increased litigation risk. Investors or creditors could seek to use the qualitative and forward-looking risk information proposed to be published under the Proposed Rule, which is necessarily inexact, as a basis for legal action against a reporting person in the event, for example, losses exceeded the probable range determined by a reporting person's risk analysis, and the Proposed Rule offers no protection from such risks.[3] Consequently, reporting persons under the Proposed Rule would be unfairly burdened by this litigation exposure as compared to unregistered or smaller competitors who would not be required to publicly disclose such information.

providers have undertaken efforts to strengthen information availability for their counterparty risk assessments,[4] and, as one bank representative testified before Congress, they do not require legally mandated disclosures to obtain the information they need.[5] Given the attendant burdens and costs on reporting persons of complying with new and complex periodic financial reporting requirements, the Committee believes the question of necessity merits close scrutiny.

In the interest of supporting regulatory rationality and efficiency and minimizing unnecessary regulatory burden, the Committee urges the Commission to carefully examine whether there currently is a need for such financial reporting. In this regard, the Committee would like to echo

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[3] It should be recalled that concerns about potential litigation based on qualitative and forward-looking risk information led the Securities and Exchange Commission (the "SEC") to include a "safe harbor" provision in its derivatives disclosure rules to protect public issuers that would be required to make such disclosures.

[4] CRMPG Report at 12.

[5] Mark C. Brickell, Managing Director at J.P. Morgan Securities Inc., testified before Congress on April 11, 2000 that new laws requiring disclosure of hedge fund financial information are not needed, stating that "financial institutions that enter into transactions with hedge funds have all of the negotiating power they need in order to obtain information to assess a counterparty's financial condition. If they are not satisfied with the information provided, they can decline to enter into any particular transaction."

Commissioner Holum's dissent and recommend that the Commission examine whether the recommendations of the PWG Report it cites remain current in light of market developments since the near failure of Long-Term Capital Management ("LTCM") and, consequently, whether a prescriptive rule on public disclosure such as the Proposed Rule is an appropriate response at this time. The Committee notes in particular that a series of public and private sector actions have been undertaken in direct response to the issues raised by LTCM.[6] In addition, credit Legislation that would require public disclosure of hedge fund information has been the subject of multiple hearings over the last eighteen months and continues to be actively deliberated on Capitol Hill. Many of the concerns raised in this letter have been raised by members of Congress in hearings and debates concerning pending legislation. The Committee believes that the Commission should not pre-empt legislative action by prematurely promulgating rules covering topics and regulatory approaches that remain the subject of legislative debate. In view of the Commission's professed interests in steamlining and reducing regulation, it would appear inconsistent to impose burdensome regulation where it may not be needed, especially at a time when regulatory approaches to address the issues raised by LTCM's demise are being debated in Congress.

The Proposed Rule should not be adopted while legislation addressing the same issue is actively under consideration absent manifest necessity.
The Proposed Rule imposes significant burden and is not clearly necessary.

Conclusion

The Committee appreciates the opportunity to submit these comments on the Proposed Rule and would be pleased to discuss these issues further with the Commission or its staff. If you have any questions regarding this letter, please contact me at 212-545-1900 or sfa@mhjur.com.

Sincerely,

Samuel F. Abernethy
Chairman

cc: Honorable William J. Rainer
Honorable Barbara Pedersen Holum
Honorable David D. Spears
Honorable James E. Newsome
Honorable Thomas J. Erickson
C. Robert Paul, General Counsel11

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[6] These include: the issuance by multiple bank regulatory bodies of extensive guidance for more rigorous practices in lending and credit management; the publication by the Counterparty Risk Management Policy Group of the recommendations in its report entitled "Improving Counterparty Risk Management Practices" in June 1999 ("CRMPG Report"); and the issuance of "Sound Practices for Hedge Fund Managers" by some of the world's largest hedge fund managers in February 2000.