COMMENT



02-14
(10)

# MANAGED FUNDS ASSOCIATION

**Via Electronic Mail: secretary@cftc.gov**

January 14, 2003

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

Re: Advance Notice of Proposed Rulemaking on CPO and CTA Registration Exemptions

Dear Ms. Webb:

Managed Funds Association ("MFA") appreciates the opportunity to comment on the above-referenced advance notice of proposed rulemaking, and accompanying release, (the "Proposed Rules") by the Commodity Futures Trading Commission (the "Commission" or "CFTC"), published on November 13, 2002 (67 Fed. Reg. 68,785). In particular, MFA would like to address its own proposed Commission Rule 4.9 ("Rule 4.9" or "MFA Proposal") which is part of the Proposed Rules.[1] MFA, located in Washington, DC, is the only U.S.-based global membership organization dedicated to serving the needs of professionals worldwide that specialize in the alternative investment industry— privately and publicly managed futures funds, hedge funds, and funds of funds. MFA has approximately 500 members who represent a significant portion of the over $600 billion invested in alternative investment vehicles around the world. Accordingly, MFA, its members, many of whom are commodity pool operators ("CPO") and commodity trading advisers ("CTA") and the investors who invest in our members' funds have a vital interest in the Proposed Rule.

MFA supports all of the Proposed Rules as they can offer some registration relief to CPOs and CTAs. With respect to the National Futures Association ("NFA") Proposal, we believe there is much merit to an exemption for entities that engage in "de minimis" futures trading, however, it does not address some of the significant issues addressed by the MFA Proposal. MFA believes that of all the Proposed Rules contained in the release,

[1] Capitalized terms used herein shall have the same meaning as those set forth in the Proposed Rules, unless otherwise noted.

Rule 4.9 will do the most to advance the goals of the Commission by reducing unnecessary and burdensome regulatory requirements imposed upon commodity pools comprised of certain qualified investors. As you are aware, MFA drafted Rule 4.9 to provide registration relief primarily for CPOs that operate hedge funds limited to qualified investors.

Rule 4.9 would provide an exemption from registration with the Commission for CPOs that sell only to individuals that are "qualified eligible persons" under CFTC Rule 4.7 or to institutions that are at least "accredited investors" as defined in Regulation D of the Securities Act of 1933.[2] We believe that the key benefits of Rule 4.9 are that the rule contains no numerical limitation on the extent of commodity interest trading in which an eligible commodity pool may participate, and that it is available on a pool-by-pool basis. Most importantly, we believe the MFA Proposal will encourage more participation in commodity futures trading by pool operators that had previously declined to engage in this market.

**Importance for the Futures Industry**

If the MFA Proposal were adopted, we believe a significant number of pooled investment vehicles which avoid futures will begin using such instruments. This can, and should, lead to greater futures product volume on U.S. exchanges. We believe that many pooled investment vehicles currently avoid using futures because of the CPO registration requirement. While private pooled investment vehicles may create investment portfolios from a vast array of assets, including, but not limited to, venture capital opportunities, real estate, and securities, such vehicles may not invest in futures unless their sponsor registers with the Commission as a CPO. In light of the many other asset classes that the sponsors of such vehicles may choose from, one can expect that many simply choose to ignore futures as an asset class as a result of the registration requirements. While we are unaware of any statistics on this subject, it is reasonable to assume that the promulgation of Rule 4.9 will remove this barrier to entry into the futures markets for this selective group of potential investors. In addition, non-U.S. sponsors of non-U.S. investment funds currently cannot, without CPO registration, offer their funds to U.S. investors if the funds use U.S. futures. Proposed Rule 4.9 would encourage use of the U.S. futures markets by these entities. Another advantage of the MFA Proposal is that it is available on a pool-by-pool basis. MFA drafted its proposal so that both registered and unregistered CPOs could operate pools exempt from the Part 4 of the CFTC rules, other than those set forth in Rule 4.9 (and described below).

Finally, if, as hoped, security futures develop into a viable and liquid product, securities investment funds will naturally desire to participate in this area for both

---

[2] Rule 4.9 incorporates certain definitions of "accredited investor" set forth in Rule 501 of Regulation D (see 17 CFR 230.501(a)(1)-(3), (7) and (8)).

speculative and hedging purposes. Again, given the already extremely liquid equity markets available to such funds, their sponsors can be expected to hesitate in expanding into security futures if registration or other costs of entry, not present in current alternatives, were to be imposed.

**Appropriate Investor Qualifications for Use of Rule 4.9**

The Commission has requested comments on the issue of appropriate investor qualifications for participation in collective investment vehicles operated or advised by persons eligible for any new CPO or CTA exemption. With respect to the MFA Proposal, the typical CPO interested in the MFA Proposal is the manager of a hedge fund who almost exclusively sells interests to investors with a high level of sophistication. Accordingly, a major premise of Rule 4.9, one that is well-established in securities law, is that there is a class of sophisticated, high net worth or well capitalized investors who do not require the added protections afforded by requiring the sponsor of a pool to be registered with the Commission. Such sophisticated investors already have a broad array of investment products available to them, which have varying levels of investor protection built in. They can choose from highly regulated and closely monitored publicly registered investment companies to unregistered privately offered investment vehicles. It is assumed that such investors have the experience necessary to assess the relative advantages and disadvantages to investing across this spectrum.

The Commission also invites comment on whether the investor qualifications under the MFA Proposal should be the same as those set by the Securities and Exchange Commission ("SEC") with respect to the definition of "accredited investor" and other terms. MFA believes that the appropriate qualification for institutional investors under Rule 4.9 would require that such investors meet the "accredited investor" definition under Rule 501 of Regulation D of the Securities Act of 1933. For individual investors, MFA believes that the appropriate qualification standard is reflected in Rule 4.7's definition of "qualified eligible person" ("QEP"). By using both the SEC's definition of "accredited investor" for institutions and the QEP standard for individuals, the MFA Proposal harmonizes commodities and securities laws where there is a common purpose of reducing regulatory burdens on entities that conduct offerings only to investors that have a high degree of sophistication.

On the issue of investor qualification, the Commission has also asked whether these qualifications should vary with the extent of non-hedge commodity interest trading activity. MFA believes that once investor qualification standards under Rule 4.9 have been satisfied, then there should be no limitation placed upon eligible CPOs on their amount of speculative futures trading. One of the key advantages of Rule 4.9, as mentioned above, is the fact that there is no numerical limitation on such commodity futures trading. We believe that tests that try to distinguish bona fide hedging from speculative transactions are arbitrary and difficult to administer. Rule 4.9 is premised on this reality

and, therefore, imposes no such limits on the extent of speculative trading practices by pool managers. This permits managers the fullest ability to engage in investment strategies that they believe to be the most effective for their investors.

**Special Call, Financial Reporting and Notice Requirements**

The CFTC has invited comments on whether persons that qualify for any new CPO or CTA registration exemption should be subject to compliance with the special call, recordkeeping and the CFTC and supplemental notice requirements of the MFA Proposal. MFA believes that the reporting obligations set forth in Rule 4.9, and as discussed below, are adequate to protect investors in pools that qualify for this proposed exemption.

Subsection (c) of Rule 4.9 requires CPOs wishing to utilize this exemption to file a "notice of eligibility" with the Commission. CPOs would have to represent that they will submit to special calls that the Commission may make, under Rule 4.9(c)(iii), in order to demonstrate compliance with this rule. The CPOs' representations in the notice of eligibility are enforceable by the Commission. If a CPO fails to comply with a special call, its exemption from registration would become void and, consequently, the CPO would be in violation of the registration requirements of the Commodity Exchange Act.

With respect to the financial reporting requirements under Rule 4.9(b), a CPO exempt under Rule 4.9 would be required to provide audited financial statements to its investors. In order to comply with this requirement, the CPO would have to keep records sufficient to prepare financial statements and permit its accountants to audit them. The financial statements would include whatever is required by generally accepted accounting principles, with noted assumptions and exceptions, and the CPO would have to satisfy its accountants in obtaining certification of those statements. In drafting Rule 4.9, it was contemplated that the CPO would provide the financial statements as required by its agreement with its investors. We believe that 180 days after the fund's fiscal year-end would be an adequate time in which any CPO could prepare such statements, as set forth in Rule 4.9(b)(ii). Most funds also provide interim information at least quarterly, but we do not believe that mandating periodic reports should be necessary.

The Commission also has asked whether there are other compliance requirements imposed upon persons who qualify for Rule 4.9. It seems unnecessary to require the exempt CPO to maintain specific books and records, other than as outlined above. Under Rule 4.7, a registered CPO is not required to maintain specific books and records other than those demonstrating compliance with that rule. Rule 4.9 is an exemption from registration and should not, therefore, require more recordkeeping than Rule 4.7. The Commission can enforce its anti-fraud and anti-manipulation requirements as it would against any wrong-doer. Investors' rights with respect to the review of documents would

be governed by the pool organizational document, as they are in any collective investment fund. Investors' rights to documents, in the context of litigation, would be governed by the applicable rules of discovery. We believe, accordingly, that other Part 4 recordkeeping should not be required.

Overall, we believe that the financial reporting and notice requirements under Rule 4.9 are satisfactory disclosure for the Commission and the CPO's investors. If a CPO is unable to comply with Rule 4.9, it must register as a CPO. Upon registration, the CPO becomes subject to the Commission's disclosure, recordkeeping and reporting requirements. If the CPO cannot comply with Part 4 recordkeeping requirements upon registration as a CPO, then it is in violation of the rules and subject to sanction by the Commission.

**Conclusion**

For the reasons set forth above, we believe that the Commission should adopt the MFA Proposal for final rulemaking. While we support the other Proposed Rules, we believe that the MFA Proposal would expand the number of pooled investment vehicles that utilize futures products. Our proposal is drafted to afford CPOs a great deal of flexibility and efficiency in carrying out its investment strategies, so long as the investors meet the appropriate qualifications.

If you have any questions regarding these matters, please do not hesitate to contact me at 202.367.1140.

Sincerely,

John G. Gaine
President