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October 13, 1998

COMMENT

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

Re: Revision of Federal Speculative Position Limits and Associated Rules - Notice of Proposed Rule Making

Dear Ms. Webb:

The Committee on Futures Regulation (the "Committee") of the Association of the Bar of the City of New York (the "Association") respectfully submits this comment letter to the Commodity Futures Trading Commission (the "Commission") in response to the notice of proposed rule making on the Revision of Federal Speculative Position Limits and Associated Rules which was published in the Federal Register on July 17, 1998 (63 Fed. Reg. 38,525) (the "Release"). The Association is an organization of 21,000 lawyers. Most of its members practice in the New York City area. However, the Association also has members in 48 states and over 50 countries.

The Committee consists of attorneys knowledgeable in the field of futures regulation and has a history of publishing reports analyzing critical regulatory issues which may affect the futures industry and related activities. The Release contains several significant proposals to increase speculative position limits, expand the relief available under rule 150.3 and codify and clarify Commission policy on aggregation of positions for speculative position limit purposes. In keeping with its practice, the Committee is commenting only on certain aspects of the Release that raise significant legal issues.

In the Release, a significant legal issue involves the proposed revisions to rule 150.4 of the Commission's Regulations dealing with the aggregation of pool and individual positions by

participants in commodity pools. Historically, passive investors in pools have been exempt from the definition of ownership for aggregation purposes. The proposal would require any person having a 25% or greater ownership or equity interest in an account or position as a limited partner, shareholder, or other category of pool participant to aggregate those accounts or positions with all other accounts or positions that that person owns or controls. Furthermore, pool participants that have a 10% or greater ownership interest in a pooled account or position with ten or fewer participants would similarly be required to aggregate these pooled account or positions with all other accounts or positions that they own or control. This departure from historical precedent, as explained in the Release, is intended to address atypical situations and is based upon the view that limited partners "may not be precluded from being involved to some degree in the partnership's trading decisions" consistent with the provisions of the revised Uniform Limited Partnership Act.

The Release states on page 38,531 that in construing section 4a of the Commodity Exchange Act, "the Commission and its predecessor agency have interpreted the 'held or controlled' standard as applying both to ownership of positions or to control of trading decisions." The Release stresses that each criterion is applied separately. With respect to control, footnote 25 describes the Commission's long-standing factual criteria for determining the existence of control by a futures commission merchant ("FCM") over trading decisions in a customer account in which a trader affiliated with but independent of the FCM directs trading.

Thus, under current law and interpretations a pool participant who controls trading decisions for a pool must aggregate those positions with the other positions owned or controlled by the participant. Under current law and regulation, however, a pool participant (other than the pool's commodity pool operator ("CPO")) who does not control trading decisions may own up to 100% of the pool without being required to aggregate positions. If the Commission's proposal is based on situations of suspected trading control by those who nominally occupy the role of passive investors, these situations can and should continue to be addressed based on the facts and circumstances of individual cases rather than by making any arbitrary percentage of ownership synonymous with control for pool participants.

The Committee also believes that there are distinctions that should be recognized for regulatory purposes among the type of pools described in the Release. For example, the business

reasons for the creation of a single investor fund for an institutional investor - often to provide limited liability to the investor - differ significantly from those leading to the creation of small pools that have fewer than 15 investors and less than $200,000 in capital contributions. While the operators of the latter type of pool may be exempt from registration as CPOs, the operators of the former type of pool would not be exempt. While a single investor fund developed by a CPO for an institutional client may have an independent account controller, a small exempt pool is less likely to be managed by an independent professional advisor.

If the small pool scenario described above is in fact the type of situation that led the Commission to propose the new aggregation rules, the Committee suggests that it might be more efficient to require that pool operators exempt under § 4.13 certify in the statement mandated by § 4.13(b) that only the trader(s) designated therein make trading decisions and/or control trading for the pool identified therein. The certification would alert those who are not already aware of aggregation requirements, and should have a deterrent effect on those who intend to circumvent the aggregation requirements by creating numerous small exempt pools. From an enforcement perspective, the filing of any false statement could be the basis for disciplinary proceedings.
The Committee also questions the necessity of codifying the view that principals and affiliates of a pool's CPO, just like the CPO itself, may not rely on the limited partner or shareholder exception from the ten percent or more ownership criterion for requiring aggregation. We believe that adoption of this view may discourage investments by principals and affiliates in commodity pools, in particular in seed money situations. The Commission recently acknowledged the significance of this consideration in another context - the final rule on post-execution allocation. 63 Fed. Reg, 45,699 (August 27, 1998). The Commission eliminated a proposed ten percent limitation on proprietary interest for eligibility in post-execution allocations, stating that it was aware that the proposed limitation does not exist in other markets and that "...eligible customers may prefer to invest with an account manager who puts his or her money at risk along with that of the customers". 63 Fed. Reg. at 45703.

Finally, proposed rule 150.4 would create additional burdens and issues for commodity trading advisors ("CTAs") and FCMs. CTAs that act as advisors to pools subject to the new rule would be required to permit disclosure of the positions controlled by the CTA for those pools to each of the investors identified by the proposed rule. Rather than do so, many CTAs may decline to advise such pools because of confidentiality concerns. Requiring

CTAs to disclose positions to passive investors in pools may permit those investors to copy the CTA's trading strategy without compensating the CTA. In addition, if the suspected type of "control" by investors in fact does occur, substantial questions may arise concerning the validity of the performance records of the CTAs who nominally control those accounts and the adequacy of the disclosures they make about their trading methods to investors and potential investors.

FCMs currently provide confirmations and monthly statements to the CPO of a pool. The proposed rule would ultimately require FCMs to obtain additional information on the structure and ownership of each pool account carried by the FCM and on specific participants in these pools. This information has traditionally been difficult to obtain since promoters do not want to disclose client information to FCMs. In addition, the FCM would have to monitor positions for such participants, and report pool positions to the participants and to the CFTC. The current large trader reporting system does not accommodate such requirements.

In sum, existing Commission rules require a person who controls trading decisions for a pool or account to aggregate those positions with others owned or controlled by that person. Therefore, the Committee believes that no new rule is needed to assure that any pool participant who controls a pool's trading (as determined by the facts and circumstances surrounding the participant's and the pool's activities) be required to aggregate individual and pool positions. Moreover, the proposal would impose additional and perhaps unnecessary burdens on CTAs and FCMs.

The Committee appreciates this opportunity to comment on the Release and stands ready to assist the Commission and its staff if further clarification is required on the points raised.

Sincerely,

Emily M. Zeigler, Chair

Association of the Bar the City of New York
Committee on Futures Regulations
1998-1999

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