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Goldman Sachs

October 19, 1998

COMMENT

Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21 Street, N.W.
Washington, D.C. 20581

Re: Speculative Position Limits

Ladies and Gentlemen:

Goldman, Sachs & Co. ("Goldman Sachs") is submitting this letter to respond to the proposal regarding revision of speculative position limits and related rules which the Commodity Futures Trading Commission (the "Commission") recently published for comment in the Federal Register. 63 Fed. Reg. 38525 (July 17, 1998) (the "Release").

Goldman Sachs is a full service investment bank and is registered with the Commission as a futures commission merchant ("FCM"), commodity trading advisor ("CTA") and commodity pool operator ("CPO") and with the Securities and Exchange Commission as a broker-dealer and investment adviser. Several of its affiliates, including Commodities Corporation LLC, are also registered with the Commission as a CTA and CPO. Goldman Sachs offers a wide variety of financial services on a global basis to corporate and governmental issuers and to institutional investors.

Goldman Sachs appreciates the opportunity to comment on the Commission's proposed rules and Release. In this letter, Goldman Sachs focuses its comments on those aspects of the Release which are of greatest concern to us. It stands ready to provide any further assistance which may be helpful to the Commission in its consideration of these issues.

In summary, we agree with the Commission's proposal to raise speculative position limit levels in futures contracts on agricultural commodities, but we object to certain of the proposed amendments to the Commission's rules relating to aggregation. By requiring aggregation based upon the ownership criterion in circumstances where aggregation is not currently required, we believe the Commission would be hindering legitimate trading and asset management activities without achieving any commensurate regulatory benefit. The Release represents a fundamental change in the direction of the Commission's aggregation policy even though no problems have been identified which suggest the need for such a change.

I. BACKGROUND

Speculative position limits restrict the number of positions which any person may hold or control in a futures contract or option on a futures contract. The Commission imposes speculative position limits for futures contracts (and options on such contracts) on various agricultural commodities (e.g., corn, oats, soybeans, wheat) which are codified in Part 150 of its regulations. 17 C.F.R. Part 150. Pursuant to Rule 1.61, the Commission generally requires that futures exchanges impose speculative position limits on contracts which are not subject to Commission limits, subject to various exceptions. See generally 63 Fed. Reg. 38525 at 38526, 38529-30.

In determining whether any person has exceeded speculative position limits, Section 4a(a) of the Commodity Exchange Act, as amended (the "CEA"), 7 U.S.C. § 6a(a), reads in relevant part that "the positions held and trading done by any persons directly or indirectly controlled by such person shall be included with the positions held and trading done by such person; and further, such limits . . . shall apply to positions held by, and trading done by, two or more persons acting pursuant to an expressed or implied agreement or understanding. . . ." See also Rule 150.4. Thus, the Commission applies an aggregation policy based upon the following factors: (i) ownership of positions; (ii) control of trading decisions; and (iii) trading in concert. In general, the ownership criterion requires aggregation of positions based upon an ownership interest of ten percent or more in an account, except for the interest of a limited partner or shareholder (other than the CPO) in a commodity pool. The Commission applies the same policy for aggregating positions for purposes of its large trader reporting requirements, which is codified in Rules 17.00 and 18.01.

In 1979 the Commission issued a Statement of Aggregation Policy (the "1979 Aggregation Policy") which states that an FCM need not aggregate positions in discretionary trading accounts or customer trading programs in which a trader employed by, or affiliated with, the FCM independently directs trading of customer owned positions or accounts. To demonstrate the trader's independence, the FCM must maintain only supervisory control over the trader, and trading decisions in the discretionary account or program must be made independently of trading decisions in all other accounts held by the FCM. 44 Fed. Reg. 33839 (June 13, 1979). The 1979 Policy Statement provides guidance as to the criteria used in determining whether the

FCM exercises control over the trading decisions of customer discretionary accounts or trading programs. These indicia of control include: agreements vesting control in the name of the FCM or the trader; statements in marketing and promotional material; agreements between an FCM and its employees or affiliated traders demonstrating independence; the degree of supervision by the FCM; the confidentiality of trading decisions by the trading program and the concomitant lack of access to, and reliance upon, market information generated by the FCM; a financial interest in an account; and the existence of common trading patterns. Id. at 33844.

In response to the rapid growth of pooled investment vehicles, in particular multi-advisor commodity pools, the Commission adopted Rule 150.3(a)(4) in 1988 to provide an exemption from speculative position limits for multi-advisor commodity pools and other similar entities using independent account controllers who make trading decisions independently on behalf of such pools and similar entities. See 53 Fed. Reg. 41563 (October 24, 1988). The Commission further extended Rule 150.3 to be applicable to CTAs for positions that are commonly owned, but independently traded, and to make the exemption self-executing. See 56 Fed. Reg. 14308 (April 9, 1991); 57 Fed. Reg. 44490 (September 28, 1992). The exemption in Rule 150.3 permits the total positions of the pool or other trading entity to exceed speculative position limits during non-spot months, but does not provide relief from any spot month speculative position limit level that may be applicable.

In addition, the staff has applied the 1979 Aggregation Policy in situations where an FCM is a component of a holding company and a CPO/CTA is being operated as a subsidiary of a common parent or as a separate division of the FCM. For example, the Division of Economic Analysis has concluded that the 1979 Aggregation Policy would apply, even where the CPO/CTA was being operated as a subsidiary of a common parent, because the customer trading program was conducted independently of any proprietary trading activities engaged in by the FCM or other affiliates and the use of separate affiliates was not intended to circumvent speculative position limits or reporting requirements. See CFTC Interpretative Letter No. 92-15, reprinted in [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,381 (September 15, 1992). We are aware that the staff has granted comparable relief in similar circumstances involving mergers and acquisitions in the financial services industry, based upon the independence of trading activities conducted by different subsidiaries of a common parent.

II. DISCUSSION

A. SPECULATIVE POSITION LIMITS

In 1993, the Commission adopted interim final amendments to the speculative position limits for futures contracts on agricultural commodities contained in Part 150 of its regulations which increased the position limit levels in other than the spot month by half of the increase it had originally proposed in two steps during 1993 and 1994. See 58 Fed. Reg. 18057 (April 7, 1993). The Commission is reproposing expansion of speculative position limits in other than the spot month to the levels originally proposed, based upon the favorable experience with the 1993 increase and the intervening growth in the size of the relevant futures markets.

We support the proposed increase in speculative position limit levels. We therefore urge the Commission to amend Rule 150.2 as proposed. We believe that the Commission should continue to monitor the appropriateness of existing speculative position limit levels, with a view to proposing additional increases to accommodate expanded trading activity and to meet evolving needs of futures market participants.

B. AGGREGATION POLICY

The Commission is proposing to amend Rule 150.3 in a number of respects to reflect the continuing trend toward mergers and consolidation in the financial services sector. In this regard, the Commission is proposing to include banks, trust companies, savings and loan associations, insurance companies and separately incorporated affiliates of any of these entities, as well as separately incorporated affiliates of CPOs, CTAs, and FCMs as eligible entities for purposes of Rule 150.3. The Commission is also proposing to include small pools whose operator may be exempt from CPO registration as an eligible entity under the exemption.

In addition, the Commission is proposing to codify in Rule 150.4 its aggregation policies, including the 1979 Aggregation Policy, which are currently contained in Rules 17.00 and 18.01. In codifying these policies, the Commission is also proposing to amend the limited partner/shareholder exception in Rule 18.01, which currently provides that a limited partner or shareholder of a commodity pool who is not the pool's CPO need not aggregate the pool's positions on the basis of ownership. Specifically, the Commission is proposing to require a limited partner or shareholder to aggregate all of the pool's positions if it has an ownership interest of 25% or more in the pool or if the pool has ten or fewer participants. The Commission is requesting comment on whether the proposed numerical criteria would reach only unusual or atypical ownership arrangements, which is its stated objective.

The Commission is also proposing to clarify that participants in other categories of limited liability business organizations such as members of limited liability companies are treated the same as limited partners or shareholders for this purpose. Lastly, the Commission is proposing to codify the view that principals or affiliates of the pool's CPO, just as the CPO itself, may not rely on the limited partner or shareholder exception from the ten percent or more ownership criterion for requiring aggregation.

(1) Proposed Expansion of Rule 150.3

The expansion of Rule 150.3 proposed in the Release would include the separately incorporated affiliates of various specified financial services companies, including banks, insurance companies, and FCMs. We are deeply concerned that this proposal is intended to codify the view that Rule 150.3 provides the exclusive basis under which relief from aggregation of positions is available for such entities rather than a non-exclusive exemption. Given the trend toward mergers and consolidation in the financial services industry, it is quite common for different subsidiaries of a common parent or different affiliated companies to be operated and controlled independently from each other, with trading and asset management activities marketed and conducted separately pursuant to independent investment decision-making processes and strategies developed by separate staffs which are supervised and managed under separate chains of command. Such entities typically do not have access to information relating to each other's order flow, positions, or trading strategies, and often use different executing and clearing brokers and different order entry, back office, computer, and communications systems, and their personnel may be physically separated from each other as well.

In these circumstances such an entity would not be able to aggregate its positions in the spot month as would be required under Rule 150.3(a)(4) because it lacks the ability to obtain information about the spot month positions of affiliated entities. Nor are affiliated entities able to allocate a spot month limit among themselves because each entity conducts its trading activities separately pursuant to separate and independent management. As a practical matter, it would be necessary for such entities to channel their futures trading activities through a central order desk which would impose restrictions on trading when a spot month limit in a particular futures contract is approached. Such a system would represent a complete change in current operations and affect the manner in which traders usually trade. We also note that Rule 150.3 requires that an independent account controller be separately registered with the Commission, but employee traders typically are not separately registered. Consistent with prior guidance provided by the staff, we believe that affiliated entities should not be required to aggregate their proprietary or client trading activities if they are engaged in different, independently managed businesses, conduct their trading activities independently, and there is no intent to circumvent speculative

position limits or reporting requirements.[1] In this regard, the Commission should confirm that an FCM and its affiliates may rely on the 1979 Aggregation Policy.

(2) Limited Partner/Shareholder Exception in Rule 18.01

We also object to the Commission's proposal to narrow the limited partner/shareholder exception in Rule 18.01. We find this proposal to be a drastic departure from longstanding policy which will discourage the formation of pools, in particular novel or unusual types of funds which frequently rely on "seed money" investments by their sponsors. In support of this proposal, the Release refers "to the possibility that limited partners may be less than wholly passive investors" and "the likelihood that limited partners may be involved to some degree in the trading decisions of the partnership's trading activity as the overall number of limited partners in a commodity pool decreases, such as in the single or limited number investor pool or when a small number of limited partners has a relatively dominant ownership interest." Id. at 38532 (Emphasis added.) Such contingent possibilities have never been thought sufficient to form the basis for proposed rulemaking, especially when the proposal sweeps so broadly, as is the case here.

First, under current aggregation policy a limited partner or shareholder of a pool who controls the pool's trading, directly or indirectly, must aggregate the pool's positions on the basis of control. In this regard, any person or entity who controls such trading is required to file a Form 40 Statement of Reporting Trader when requested to do so. If someone else actually controls the trading and such control is not disclosed, the person or entity filing the Form 40 would be filing a false report with the Commission, with all the attendant consequences under the CEA. Second, even though the purported focus of the proposal is on the operators of small pools who are exempt from CPO registration pursuant to Rule 4.13,[2] the numerical criteria would

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[1] We also note that the language in the Release describing this proposal is ambiguous and can be read to suggest that aggregation is required even where affiliated entities independently direct trading of different client accounts. ("During the spot month, all of the affiliates' accounts . . . must be aggregated for speculative position purposes as positions belonging to a single owner.") Id. at 38532 (Emphasis added). We believe that aggregation is not required in such circumstances, because there is no common ownership of positions, nor does common control exist.

[2] Rule 4.13 provides two extremely limited exemptions from CPO registration as follows. Rule 4.13(a)(l)(i) exempts an operator who (i) does not receive any compensation for operating the pool, except reimbursement for ordinary administrative expenses; (ii) operates only one pool at any time; (iii) is not otherwise required to register with the Commission and is not a business affiliate of any person required to register with the Commission; and (iv) does not arrange for any advertising for the pool. Rule 4.13(a)(1)(ii) exempts an operator of pools where (i) the total gross capital contributions it receives do not in the aggregate exceed $200,000 and (ii) none

reach many funds privately offered by registered CPOs. For example, in seed money situations where an affiliate of the CPO wishes to demonstrate to potential clients that the affiliate is committing its own capital to a particular strategy, its percentage share could well exceed 25%. It is also common for the initial offering of a pool to close and for the pool to begin trading after one or two large investments have been made. Such situations would run afoul of both criteria. As a result, the use of such criteria inevitably would result in anomalies and distortions, such as a fund sponsor seeking to bring in additional investors with minimal ownership interests in order to reach the threshold of eleven participants.

Third, we believe that adoption of this proposal would be inconsistent with the Commission's recent determination to eliminate the less than ten percent restriction on proprietary interest that would have been applicable in determining eligibility for bunching orders for post-trade allocation under proposed rule amendments to Rule 1.35(a-1). 63 Fed. Reg. 45699 (August 27, 1998). In response to comments, the Commission recognized that eligible customers "may prefer to invest with an account manager who has a significant proprietary interest in the trading activity, i.e., an account manager who puts his or her money at risk along with that of the customer." Id. at 45703. The same rationale supports eliminating this proposal.

In addition, even if we assume that the Commission amends Rule 150.3 as proposed on this point, only a limited partner or shareholder of a pool whose CPO is exempt from registration under the limited exemptions in Rule 4.13 would qualify for relief. For example, relief would not be available to limited partners or shareholders in a pool if the operator of the pool is registered as a CPO or is not registered pursuant to a staff no-action letter.[3] Moreover, we do not believe that such relief would be of any practical benefit, because limited partners or shareholders would need to aggregate the pool's positions in the spot month which means that they must obtain information on the pool's spot month positions on a real time basis. Because limited partners or shareholders of a pool do not ordinarily receive position information on a real time basis or otherwise, presumably it would be necessary for the pool's CPO to provide that information to them on a timely basis. However, CTAs view this information as confidential and proprietary, so that maintaining the confidentiality of this information is typically a heavily negotiated issue in

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of the pools operated by it has more than fifteen participants, excluding the pool's CPO, CTA, the principals thereof, and any relative, spouse or relative of such spouse living in the same household as any of the foregoing persons.

[3] It is unclear from the Release as to whether the pool or the pool's CTAs would need to be independent of the limited partners or shareholders for them to qualify for relief. Id. at 38533 n.32. We believe that if the pool's CTAs trade independently for the pool, any concerns about circumventing speculative position limits or position reporting do not arise and aggregation should not be required.

management agreements entered into between pools and their CTAs. For this reason, CTAs frequently prefer to trade pooled accounts rather individual managed accounts.

(3) Treatment of Principals or Affiliates of a CPO Under Rule 18.01

Lastly, we disagree with the Commission's proposal to codify the view that principals or affiliates of a pool's CPO, just as the CPO itself, may not rely on the limited partner/shareholder exception from the ten percent or more ownership criterion for requiring aggregation. The Release states that "[t]he Commission is of the view that principals and affiliates of the commodity pool operator were intended to be treated under the rule the same as the commodity pool operator itself." Id. at 38533 (Emphasis added). We disagree. Rule 18.01(a) by its terms excepts only the CPO of the commodity pool from the limited partner/shareholder exception. It does not specify any other entity, including principals or affiliates, nor have we located any interpretative letter, advisory, decision or release which suggests that any entity other than the CPO of the commodity pool at issue is intended to be precluded from relying on the limited partner/shareholder exception.[4]

Under Section 1a(4) of the CEA and Rule 1.3(cc), a CPO is defined as any person engaged in a business which is of the nature of an investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of futures trading. The Commission staff has interpreted the CPO definition to be applicable to any individual or entity that "handles or exercises control over the funds of persons who invest in" a commodity pool, and has explained that the definition is intended "to cover all of the means by which a person can obtain control over pool participants' funds." CFTC Interpretative Letter No. 75-17, reprinted in [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,112 at 20,810 (Nov. 4, 1975) (emphasis in original); Id. at 20,810-11. The Commission staff also has identified the following functions as key characteristics in determining whether a person or entity is acting as a CPO: soliciting funds for a pool; directing, supervising, or controlling a pool's funds; managing a pool, including supervising the activities of other partners, officers, employees, and agents in connection with the pool's operation; and possessing the authority to enter into, or terminate, contracts for

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[4] We do not understand the reference in the Release to the treatment of FCMs investing in customer trading programs or pools under the 1979 Aggregation Policy. Id. at 38533. As noted, while the 1979 Aggregation Policy provides that a financial interest in an account of less than ten percent may be an indication of control, such an investment by an FCM without more does not require the FCM to aggregate positions in customer trading programs or pools. ("[A]ny financial interest may also be indicative of control of the account. Thus, a financial interest held by an FCM in a customer trading program will be considered for this purpose.").

commodity trading advisory and brokerage services on behalf of a pool. See, e.g., CFTC Interpretative Letter No. 94-27, reprinted in [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,018 (March 16, 1994); CFTC Interpretative Letter No. 93-70, reprinted in [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,799 (July 21, 1993); CFTC Interpretative Letter No. 93-47, reprinted in [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,738 (May 12, 1993); CFTC Interpretative Letter No. 75-11, reprinted in [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,098 at 20,762 (Sept. 19, 1975). We recognize that if an affiliate or principal is performing the functions typically engaged in by a CPO with respect to a commodity pool, then it could be appropriately viewed as the de facto CPO of that pool. Consistent with the approach adopted in these letters, such a determination depends upon an analysis of the particular facts and circumstances involved and therefore must be made on a case-by-case basis.

As a practical matter, codifying this view will restrict investments by affiliates in commodity pools which may be necessary in seed money situations and similar circumstances to provide sufficient funds for economies of scale, investment flexibility, and marketing support. As noted, the Commission recognized the significance of proprietary investments by account managers and their affiliates in connection with deleting the restriction on proprietary interest that had been proposed for purposes of bunching orders of eligible accounts for post-trade allocation. 45 Fed. Reg. 45699, 45703 (August 27, 1998). This view is also inconsistent with the Commission's recognition elsewhere in the Release that affiliates may possess "independent trading authority with appropriate safeguards to maintain the affiliates' independence and the confidentiality of the affiliates' trading decisions." Id. at 38532. In the absence of any problems which suggest the need for such a change, we urge the Commission not to proceed with the proposed codification. We further urge the Commission to confirm that principals and affiliates of the CPO may rely on the limited partner/shareholder exception from the ten percent or more ownership criterion for requiring aggregation.

III. CONCLUSION

Based upon the foregoing, we believe that the Commission should (i) amend Rule 150.2 as proposed and (ii) withdraw the proposed amendments to its current aggregation policy and provide the requested confirmation. If the Commission or its staff wishes to discuss any of the comments submitted in this letter, please do not hesitate to contact Bonnie S. Litt at (212) 902-1212 or Joseph F. Esposito at (609) 497-5517.

Sincerely,

Goldman, Sachs & Co.

Goldman, Sachs & Co.

cc: The Honorable Brooksley E. Born
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