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COMMENT

October 25, 1999

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

Re: Proposed Exemption from Registration for Certain Foreign FCMs and IBs

Dear Ms. Webb:

The Managed Funds Association (MFA) respectfully submits this comment letter to the Commodity Futures Trading Commission (CFTC or Commission) on the CFTC's release published August 26, 1999 at 64 Fed. Reg. 46618 (Release). In the Release, the CFTC seeks comment on a proposal to amend the foreign futures and foreign option rules to include a new Rule 30.12, under which certain foreign firms acting in the capacity of futures commission merchants (FCMs) and introducing brokers (IBs) would be permitted to accept and execute foreign futures and option orders directly from certain U.S. customers by means of telephone, facsimile and electronic message without having to register with the CFTC.

MFA fully supports the Commission's goal of increasing the ability of sophisticated investors to centralize their futures and options transactions through a U.S. FCM while preserving direct access to international markets. MFA also agrees with the Commission's objective of "strik[ing] a reasonable balance between permitting and encouraging market efficiency and growth, and protecting against known risks, particularly those that have systemic implications."

Authorized Customer Definition. MFA does not believe, however, that the Commission's definition of "authorized customers" who may deal directly with foreign firms under the proposed new exemption accords with the agency's stated objectives or sound regulatory policy. In particular, we note that the Commission states that its definition is designed "to identify those sophisticated investors who it reasonably believes will appreciate the additional risk associated with transmitting orders to foreign brokers not registered or supervised by the Commission and who are sufficiently well-capitalized to withstand the risk of such transactions." However, the Commission proposes to establish a total asset requirement for

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1200 19th Street, N.W. Suite 300 Washington, DC 20036-2422 Tel: 202.828.6040 Fax: 202.828.6041 Web site: www.mfainfo.org

commodity pool operators and commodity trading advisors that represents an unjustifiable departure from all of the other comparable measures of sophistication in use by the Commission and which is dramatically at odds with the standards proposed by the Commission for other categories of "authorized customers."

Specifically, the $50 million threshold for CPOs and CTAs vastly exceeds (by a factor of ten) the maximum asset requirement for pools to be eligible for exemptive relief under other CFTC rules, including the standard for participation in essentially unregulated swap transactions under Part 35, the Rule 4.7 exemption and the Part 36 exemption for Section 4(c) contract market transactions. The proposed threshold also is vastly out of correlation with the financial requirements for other types of entities deemed to qualify as "authorized customers" under proposed Rule 30.12. The $50 million minimum asset pool is five times higher than the asset requirement for corporations, partnerships and other business entities which may or may not have any experience in the futures markets, foreign or domestic.

The Commission's apparent justification for its use of a higher asset threshold for CPOs and CTAs in this context as opposed to its various other regulatory benchmarks of financial sophistication is that futures industry professionals generally are licensed based upon a proficiency examination which addresses the risks of commodity markets but "their proficiency may not necessarily include an understanding of the risks of dealing in foreign futures and options." MFA submits that the Commission's analysis in this respect is seriously flawed. In fact, the proficiency test required of commodity professionals addresses the fundamental risks of all futures trading. Based upon this license, CPOs and CTAs regularly trade for commodity pools and other customers on domestic and foreign futures markets, and over-the-counter and cash markets, through an extremely wide variety of strategies which call upon the CPO's and CTA's ability to appreciate and assess the full array of markets, products and sources of risk. Moreover, whether a CPO or CTA manages $5 million in assets or $50 million in assets, its expertise in and familiarity with the risks of foreign futures and foreign options trading is certainly no less than, and likely significantly greater than, that of the corporation, partnerships, insurance companies and investment companies for which the Commission's "authorized customer" definition provides either no minimum asset threshold or an asset level that is a small fraction of that applicable to CPOs and CTAs.

The Commission's only apparent rationale for creating a higher asset threshold for CPOs and CTAs than for other "business associations" for which a $10,000,000 asset standard is proposed, is that "since business associations are putting their own funds at risk, and not the funds of a third party investor, the Commission proposes to require a lower level of net assets to serve as a proxy for financial sophistication." However, this rationale assumes that "business associations" do not have "third party" investors when in fact, in many, if not most cases, they do -- shareholders of publicly held corporations or investors in partnerships, for example. Moreover, there appears to be no factual basis for the Commission's presumption that CPOs and CTAs who have $50,000,000 under management, as opposed to $10,000,000 or $5,000,000, have any materially greater understanding of the risks involved in use of proposed

Rule 30.12 procedures than those who do not, or that other business associations satisfying the $10,000,000 threshold have any minimum level of sophistication as to the relevant risks.

The arbitrariness of the Commission's proposed asset requirements for CPOs and CTAs is demonstrated by the fact that a commodity professional who by definition and registered status is qualified to transact in futures must nonetheless satisfy a financial standard of $50,000,000, when the operator of an investment vehicle which is expert principally in securities transactions -- an investment company -- and who has not established by registration status or otherwise knowledge of the risks of futures trading, whether domestic or foreign, is subject to no asset standard whatsoever. The effect of this disparity is direct discrimination against the CFTC registrant, who should be presumed to be -- and is in actuality highly likely to be -- far more familiar with the risks of transacting in futures markets, whether foreign or domestic, than the operator of a fund who is not a CPO or CTA.

MFA submits that the Commission's objectives in the context of proposed Rule 30.12 do not warrant a departure from the standards of financial sophistication which it has used with significant consistency for the past eight years in identifying those entities able to assess the risks of reduced or different regulatory requirements. MFA believes that it is both unnecessary and harmful to engraft a new standard of financial sophistication, particularly one which will operate to discriminate against CFTC registrants, onto the Commission's rules. MFA therefore recommends that the Commission conform the authorized customer standards in proposed Rule 30.12 to those previously adopted in Parts 35 and 36 and Rule 4.7 of its rules. In this regard, we note that MFA supports the use of a single "authorized customer" definition for all purposes under the Commodity Exchange Act and that the definition of "eligible swap participant" in Part 35 is essentially the same as the definition of "enumerated person" in the National Futures Association (NFA) proposal for harmonization of the Commission's various "sophisticated customer" definitions, submitted to the Commission for approval in 1998. MFA respectfully requests that the Commission give favorable consideration to NFA's proposed definition.

<u>Technical Revisions to Definition</u>. MFA also believes that certain ambiguities in the rule as proposed should be corrected. As currently drafted, the proposed rule defines CPOs and CTAs with $50,000,000 in funds under management as "authorized customers." The Release accompanying the proposed rule indicates that the Commission's intent is to make the <u>customers</u> of CPOs and CTAs satisfying the specified benchmark "authorized customers" rather than to refer merely to the CPO or CTA as an "authorized customer" when trading for its own account. MFA recommends that the proposed rule be revised to make clear that a commodity pool operated by a CPO satisfying the benchmark asset level is an "authorized customer" and that the customer of a CTA satisfying the benchmark asset level is an "authorized customer," without regard to the sophistication or asset level of the underlying customer or pool participant.

We also note that the proposed definition of CPOs constituting "authorized customers" under Rule 30.12 would require $50,000,000 "under management for the purpose of trading in any commodity for future delivery or commodity option on or subject to any contract market or foreign board of trade." In addition to MFA's previously stated concerns as to the proposed minimum asset requirement, MFA believes that there is significant ambiguity in and, potentially, a further restrictive effect to the qualifying phrase concerning the "purpose" for which the assets are held. Most commodity pools do not trade exclusively in the futures markets and, in fact, place most of their funds in other types of instruments. We do not believe that the reference to assets under management for a particular "purpose" is a restriction intended by the Commission or that such a restriction is either workable or necessary. MFA urges the Commission to eliminate this further potential obstruction to the use of proposed Rule 30.12.

Automated Order Routing Systems. MFA questions the Commission's restriction of proposed Rule 30.12 transactions to preclude authorized customers from placing orders with a foreign broker by means of an automated order routing system (AORS). MFA believes that the Commission's proposal provides for ample safeguards of customers, futures commission merchant merchants and other market participants who could be affected by the transmission of orders to foreign brokers pursuant to proposed Rule 30.12. These protections do not depend upon the medium by which the order transmittal takes place. MFA urges the Commission to include within the ambit of proposed Rule 30.12 orders transmitted by an AORS and to endeavor to construct regulatory approaches in this and other contexts that do not disadvantage the use of particular technologies.

MFA appreciates the opportunity to contribute to this rulemaking process and would be happy to respond to any questions or to provide further information that may be relevant.

Sincerely yours,

John G. Gaine

John G. Gaine
President