COMMODITY FUTURES TRADING COMMISSION

Roundtable on CPO and CTA Issues

September 19, 2002
10:07 a.m.

3 Lafayette Center
1155 21st Street, NW
Room 1000
Washington, D.C.

PRESENT:

Chairman Newsome
Commissioner Erickson
Commissioner Lukken
Commissioner Brown-Hruska
Commissioner Holum

CFTC STAFF Present:

Jane Thorpe
Pat McCarty
Larry Patent

PARTICIPANTS:

Theresa D. Becks
Arthur F. Bell, Jr.
Christopher Concannon
George E. Crapple
Daniel A. Driscoll
Susan C. Ervin
John G. Gaine
Karen Garnett
Kenneth S. Gerstein
David Harris
Steven B. Olgin
C. Robert Paul
Richard T. Prins
Jack Rigney
Paul F. Roye
Marianne K. Smythe
David J. Vogel
Emily M. Zeigler

P R O C E E D I N G S

CHAIRMAN NEWSOME: I would like to welcome and thank everyone for participating in this roundtable discussion of overlapping CPO and CTA issues this morning. I'm really looking forward to a very informative meeting.

We have got a very full schedule today, so we are going to try and keep on target so that we can address all of the agenda items that we expect to.

However, before we begin, I would like to have a moment of silence for Commissioner Bob Martin. Commissioner Martin was one of the original commissioners of the CFTC, and many of you know him personally. He was a real industry leader. In fact, he is the first loss in the family of CFTC commissioners, which is quite amazing. But he was known to be very effective, very well liked by his fellow commissioners, by CFTC staff, and by market participants. He passed away Friday. The funeral was yesterday. But before we have a moment of silence, I wanted to ask Jack Gaine if he had any thoughts. Jack was very close to Commissioner Martin and, in fact, was at the funeral yesterday.

So, Jack, any thoughts you might have.

MR. GAINE: Thank you, Mr. Chairman.

The Commission of the late '70s was very different from the Commission today, and I had the privilege of speaking at Bob's service yesterday. He made a great founding contribution to the development and makeup of this Commission. I look around and there may be a dozen of us who remember or were here. He kept us on course. He was a little short on patience, but we have seen that in others, and he was just a wonderful man, and we will miss him.

CHAIRMAN NEWSOME: Thank you, Jack. Let's take a moment.

[Moment of silence.]

CHAIRMAN NEWSOME: Thank you.

This is the second of three roundtables that we recommended in the intermediaries report that we sent to Congress in June, and I can say on behalf of the Commission that we look forward to hearing the valuable insights that each of you will bring to this discussion today.

I would first like to give a warm welcome to Paul Roye, Marty Dunn and Karen Garnett from the Securities and Exchange Commission. Mr. Roye is

the director of the Division of Investment Management. Mr. Dunn is the deputy director of the Division of Corporation Finance, and Karen Garnett is the assistant director of Corporattion Finance. I have forged a very good working relationship with SEC Chairman Pitt through the joint promulgation of rules for security futures products, and through our work as members of the President's Working Group on Financial Markets.

I really feel that this meeting is about coordination and cooperation, where it's meaningful to industry participants, and certainly from our point of view, Mr. Director, we look forward to the comments of the SEC as we move forward. And again, we thank you for taking time to be here.

During our public hearing on the intermediary study in June, members of the managed funds community, including a number of you around this table, expressed concerns over redundant regulatory burdens, overlapping requirements, inefficiency in oversight efforts, and we are here today simply to listen to those concerns, to listen to you, to build on the record that we initiated in our June meeting, and to discuss suggestions for moving forward to make our regulatory framework

more flexible, more responsive, and more efficient.

We have a very full agenda today for this roundtable. The topics that we intend to explore include defining sophisticated persons, interpreting exemption requirements, reviewing disclosure documents, and communicating with prospective participants.

We will also discuss the impact of security futures on managed funds, and will have some time at the end of the agenda for you to bring up any other CPO or CTA issues that are not on the agenda.

I would like to introduce our staff participants from the CFTC today. To my immediate right is Pat McCarty, our general counsel, and to my immediate left is Jane Thorpe, who is director of our clearing and intermediary oversight division. As well, we have got Larry Patent, who is the deputy director in that division.

Jane has graciously agreed to moderate this discussion as she did at our first roundtable.

I would also like to welcome our newest Commissioners, Commissioner Walt Lukken, and Commissioner Sharon Brown-Hruska, who join today Commissioner Barbara Holum and Commissioner Tom

Erickson at their first public meeting of the Commission, and we certainly welcome each of you.

I would like to give my fellow Commissioners an opportunity to make any comments that they so choose as we begin, and first I will ask Commissioner Holum.

COMMISSIONER HOLUM: Thank you, Mr. Chairman. I would just like to join you in welcoming all of you here, and I am especially pleased with the representation from the SEC. This is a relationship that the Chairman has worked very hard to forge, and I think it will be to the benefit of all of us. Thank you.

CHAIRMAN NEWSOME: Thank you, Commissioner Holum. Commissioner Erickson.

COMMISSIONER ERICKSON: I, too, would just like to join both of you in welcoming everyone to the table today. I would like to thank the Chairman and his staff, in particular, for keeping us on track by hosting these roundtables to better inform the Commission on issues that are important to the industry. I am looking forward to this process. Thank you.

CHAIRMAN NEWSOME: Thank you, Commissioner Erickson. Commissioner Lukken.

COMMISSIONER LUKKEN: I just want to thank everybody for coming today, and especially to Jim and to Jane for setting this up. This is my first public meeting, so it's exciting to meet all of you and to talk about these important issues. I think for me this is a sort of a first step in a sort of smarter regulatory approach. Last week I outlined some of my philosophy on regulation which is that we should tailor regulations to effectively meet public policies, but not so that it puts unnecessary costs on individuals or firms. And I think this is a first step in trying to meet those goals, and I commend Chairman Newsome for moving in this direction, and look forward to the testimony.

CHAIRMAN NEWSOME: Thank you, Commissioner Lukken. Commissioner Brown-Hruska.

COMMISSIONER BROWN-HRUSKA: Well, I also would just like to thank the Chairman and Jane for moderating and putting together this fine program. I think that this is just a very exciting time to be a Commissioner and to be here in this industry. The spirit of the congressional intent that was outlined in the Commodity Futures Modernization Act is alive and well here and, as you know, seeking ways to avoid duplicative, redundant regulations, to

harmonize differences across regulatory agencies, to bring us together and allow business basically to function better, and avoid legal uncertainty that can hamstring innovation and risk-taking, which is very important to this industry.

So I would just like to say that I hope that we can come up with some improvements and some efficient solutions to problems that you outline here. I will be listening closely and looking forward to your comments.

CHAIRMAN NEWSOME: Thank you, Dr. Brown-Hruska.

At this point in time, Jane, I will turn it over to you to begin.

MS. THORPE: Thank you, Chairman.

I would also like to thank the members of the CPO-CTA Roundtable team for helping to organize the event and for preparing all of us for the discussion today. From the Division of Clearing and Intermediary Oversight, I would like to thank Larry Patent and Barbara Gold, Chris Cummings, Kevin Walek and Eileen Chotiner. From the General Counsel's Office, I would like to thank Pat McCarty, Gloria Clement and Michael Garawski. Thank you all very much.

We have a lot of very important issues to

discuss in a little over two hours this morning, and to facilitate the discussion, we have enlisted the services of various roundtable participants who will take a few minutes to tee up specific topics for discussion. We would then like to hear from as many of you as possible on each of these topics.

The Commission will hold the record open until September 27th, if there are additional points you or members of the public would like to submit in writing.

And, finally, we are all aware that this topic gives us all an opportunity to demonstrate our encyclopedic knowledge of acronyms and rule citations. However, as a point of personal privilege, I would request that we discuss these issues in plain English, whenever possible.

Before I start, I would like to ask the SEC representatives if they would like to say a few words.

MR. ROYE: Thank you, Jane, and thank you, Chairman Newsome, and the other Commissioners of the CFTC. I am obliged to say before I make any statement that the views I express are my own and they don't necessarily represent the views of Chairman Pitt or the other Commissioners.

But let me say that we do appreciate the invitation, the opportunity to be here with you. We share the common goal of trying to make sure that our regulations are not overly burdensome, that they are not duplicative. There are areas where we can work together to harmonize the regulatory regimes. We each have our respective statutes that we administer, we have our respective missions, but within those missions, we ought to be able to reach in various areas ways that we can minimize the burdens on the industries that we regulate.

Of course, there are certain circumstances where legislatively, because of the statutes and the way they are structured, we don't have that flexibility and maybe changes ought to be made.

But, you know, we are here primarily to listen, to learn. I think that, you know, we do hear from our constituents in terms of issues that come up, but roundtables like this, I think, are really valuable in terms of forcing issues that we ought to be thinking about on the table, and we look forward to learning through this process and, you know, we look forward to hearing directly from the people that we regulate on issues like this as

well. And we will be anxious to see what's in the record that's generated from this roundtable, and we look forward to working with the CFTC on these issues.

So thank you very much for the invitation.

MS. THORPE: Thank you very much. Karen, would you like to say a few words?

MS. GARNETT: Yes, thank you, Jane and Commissioners.

I would just really echo Paul's remarks. We are very happy to be here. For those of you who may have had contact with my division, I am with the Division of Corporation Finance, and I think most of you probably are more familiar with Paul's shop than with ours, because we don't see that many public commodity pool offerings, but when we do see them, they come in to my office and I am responsible for the group that reviews the disclosure and makes those registration statements effective.

Like Paul, we are very happy to be here, and to hear the views of those of you who are in the regulated community, views about the disclosure review process, as well as the disclosure requirements under the SEC rules.

We are also eager to achieve efficiency wherever we can, and the SEC as a whole is always looking at ways that we can be more efficient in our review process as well as our other interactions with the industry. So we are looking forward to the remarks today, and like Paul, we are primarily here to listen and to answer any questions that we can. But thank you again for having us.

MS. THORPE: Thank you very much. And before we go into our first topic, I would like to ask Jack Gaine, president of the Managed Funds Association, to say a few words on behalf of the industry that he represents. Jack.

MR. GAINE: Thank you, Jane. First of all, I want to thank you, Mr. Chairman and Jane and Pat and Larry and the rest of your staff, for pulling this together. This is a wonderfully talented group. I will exclude myself from it. But when I look around the table, I know most of the people, either personally or by reputation. This is the best and the brightest in the managed funds area.

As you know, I am president of Managed Funds Association. We represent the alternative

investment industry which particularly includes hedge funds and futures funds, and if the answer isn't around this table, it doesn't exist. But I just have to make two quick asides.

I regret in one way that my friend, John Damgard, is not able to join us today. That's the regret. But the good news is that should give everyone the opportunity to say a few words, at least, so we won't be fighting over the microphone.

[Laughter.]

MR. GAINE: And I will say I mentioned earlier when talking about Bob that in the late '70s it was a very different commission from what it is today, and I think the presence of Paul Roye and Karen Garnett and Marty Dunn demonstrate that.

Back in the late '70s, the commission, this commission, so we don't confuse them, was authorized in 1974. Its first reauthorization came up in 1978, and strangely enough, there was a very heated, heated argument and debate over futures on equity securities, and we had very, very heated discussions with the then general counsel -- I was general counsel here -- of the SEC, whose name, I think, was Pitt, Harvey Pitt.

Anyway, the issues stay the same, the

people change a little bit. I want to thank you, Jim Newsome and Jane, for this, and I think this will be very productive, and we'll make some real progress.

MS. THORPE: Thank you very much, Jack. Well, let's get into the topics. The first item on our agenda is registration requirements and definitions, and we have asked Emily Zeigler to tee up the issue of the multiple definitions of sophisticated investors that all of us have to deal with. Thank you. Emily.

MS. ZEIGLER: Hi. Thank you, Chairman Newsome, Commissioners. I am very proud to be here today. I appreciate the opportunity to participate in the roundtable.

In case anybody is wondering, I am a partner at Willkie, Farr & Gallagher in New York, and most of my clients are pool operators, trading advisors, investment advisers, and the funds that they manage.

I started in this business over 20 years ago, and at that time there was a clear delineation between the regulation of futures professionals and futures, and securities professionals and securities. Your typical futures fund only traded

futures, maybe held T-bills, Treasury bills, as margin, and the typical mutual fund or typical hedge fund invested only in securities.

Then along came financial futures and stock index futures, and the world changed. Over time almost all CTAs wanted to use some securities or derivatives in their trading, and I don't know of any securities professionals, even in the mutual fund land, investment company land, I guess that would be, who don't want to use futures for at least hedging purposes. And once we get security futures on the road and tradeable, even more managers are going to want to use them.

So although the regulation of futures and securities are generally as separate as they used to be all those years ago, the business of money managers is really not. There aren't any such boundaries in that world. And the result is that they are regulated in various ways by the CFTC and the SEC, and some of that regulation can be conflicting, complex, duplicative, all those things that were just said before.

So I do applaud the commission for its foresight in convening this roundtable and trying to explore the problems and maybe even find a

couple of solutions.

As to the topic at hand, I have been asked to talk about the definitions and what we might be able to do to streamline them or coordinate them.

The Commodity Exchange Act, the Securities Act, the Investment Company Act, the Investment Advisors Act, are all designed at least in part to protect investors, and in designing this kind of protection, the Congress, the SEC and the CFTC have taken the view that certain groups of investors are sufficiently sophisticated that in specific instances they don't need all the protection of a particular statute or at least some of the protection of that statute.

As a result, we have all different kinds of categories of what are called sophisticated persons, and they have been created by the various agencies and statutes.

Some of the definitions are similar. Almost none of them are identical, and everybody in this business as a professional money manager needs to understand all of them.

Just running down the list, so we will be all talking on the same page, the CEA and -- the Commodity Exchange Act and the Commodity Futures

Trading Commission have invented eligible contract participants and eligible commercial entities. These are folks who are permitted to engage in various OTC activities without CFTC jurisdiction. People, if it's a person, an eligible contract participant, is someone with 10 million in assets, and entities vary, but some of them have say 5 million in assets. That's a commodity pool.

In addition to eligible contract participants, we have another term in the CFTC regulations, institutional customer, which is defined to mean the same as an eligible contract participant, but nonetheless another term.

Separately we have the qualified eligible person, who is someone permitted to invest in a privately offered commodity pool or open a managed futures account without receiving specific disclosure and certain reporting.

Those folks are basically accredited investors as defined by the SEC, and I'll get to that in a second, who have $2 million in an investment portfolio. There are also some otherwise regulated or registered entities that qualify without the portfolio, but for this purpose, $2 million.

In connection with the Securities Act, the SEC has invented accredited investors under regulation D, and these are folks who are permitted to purchase unregistered securities in private offerings without specific disclosure.

Individuals are accredited investors if they have $1 million net worth or $200,000 annual income. Entities vary somewhat, but generally require 5 million in assets.

Under the Securities Act as well, there are qualified institutional buyers. These are folks who are permitted to enter into unregistered resales of restricted securities, and they are institutions with 100 million in securities investments, and some dealers with 10 million.

Under the Investment Company Act, Congress invented qualified purchasers, and these are people who can invest in privately offered hedge funds excluded from the definition of investment company under section 3(c)(7) of the Investment Company Act. These are essentially individuals with 5 million in investments and entities with 25 million in investments.

And finally, in connection with the Investment Advisers Act, we have got qualified

clients, and these are people who are able to pay a certain kind of incentive fee, the one that we in futures land are so fond of, and they are people who have either $750,000 under management with the manager, or $1.5 million net worth.

Now I look around the table and I see sort of glazed eyes, and all I can say is, think of the poor clients. It's an extreme amount of information to understand and to apply.

Oh, and I guess just as a sideline, recently the SEC, to make things a little more confusing, has decided that qualified purchaser with a small “q” and a small “p” is equal to an accredited investor, if you're talking about preemption, state preemption under NSMIA. So yet another confusion.

You look at all these definitions and you say is there any way to coordinate them, and I don't know about that, but we tried to look for some common threads.

It seems to me that, first of all, all of them seem to be measures of wealth. Whether or not that is a good measure of sophistication, who knows, but everyone seems to agree that that's all you can look at, to be objective about it.

And, secondly, they all result in, or most of them, result in reduced disclosure or in no disclosure in some cases.

Separately, some of these things seem to impose an additional creditworthiness standard on the investor, for example, the ECP definition and QIBs to some extent as well.

Okay. So if everything is a measure of wealth and everything, or more or less everything, results in reduced disclosure, can we do anything to coordinate the definitions?

I think a good starting place would just be with the use of terminology. If all of these definitions used, for example, the accredited investor standard as a start and then added to them as necessary or if necessary, to comply or to accommodate different purposes of the different statutes, that would probably be a good idea. I picked accredited investor because that is the oldest, the most analyzed, and the most construed definition of them all.

It would seem to me that under this regime, we could basically replace QEP and QP -- I understand this is difficult and some of this requires statutory changes and some of it doesn't,

but in a perfect world, you could replace qualified eligible participants and qualified purchasers with accredited investors for everybody.

Or if that's not good enough, maybe accredited investors as a definition for institutional investors, and accredited investors plus a $2 million investment portfolio for individuals. That's somewhat like our QEP definition today.

Similarly, the qualified client definition might be called instead accredited investors plus a $2 million investment portfolio, or make it 1.5, if that's what is appropriate.

Institutional customers. They should be, it seems to me, accredited investors plus a $2 million portfolio. It's not clear to me why they need to be eligible contract participants in order to open up a brokerage account without all of the disclosures that regular clients get.

And, finally, we have eligible contract participants, which maybe could be called accredited investors with assets of 10 million or investments of 100 million, or make up the numbers as you choose, but as a base, accredited investor.

And, finally, then you would have eligible

commercial entities and qualified institutional buyers, and these people could be institutional ECPs or institutional accredited investors with various net worth and/or investment qualifications.

So it is the only suggestion I have got, and I understand that, as I said before, a lot of it would be difficult to achieve. But coordinating these different definitions in some way would make regulation comprehensible, both for the professionals and for investors.

Thank you.

MS. THORPE: Thank you very much, Emily. I realize that there are a lot of acronyms in Emily's presentation, but unfortunately unless we lay the foundations for our discussion for the rest of the morning, it is very difficult to understand, you know, what it is that we're trying to get at, and actually it was a very important process that you took us through, Emily, so thank you for that.

Would any of the other roundtable participants like to comment on the issue? Yes, Ken.

MR. GERSTEIN: Thank you. My perspective on a lot of this -- I'm a partner at Schulte Roth in New York, and we practice mostly in the

securities funds area, investment funds of various kinds, including hedge funds and registered investment companies, and yes, it is a complicated world of a lot of acronyms, but, you know, the lawyers can figure all that out and draft the documents that get the right people in the fund and limit it the right way, and I think really where these things are most problematic from our perspective are to the extent that they are affecting the products you design and who you can offer them to. And it's that difference between the pure commodity fund and the securities based fund, and when you start, as Emily said, you get products that are now blending the two, and we are seeing more and more of that. That is where, I think, there has to be some thought given to how we can find some common ground.

From the securities law point of view, the types of funds that are the sophisticated funds that -- the hedge funds, rely on section 3(c)(7) of the Investment Company Act, and that's where the qualified purchaser definition comes in, and that's for an individual a $5 million net worth requirement.

In the case of a normal type of hedge

fund, the standard that would typically come into play -- excuse me, not $5 million net worth, $5 million of investments.

In the case of what we call a 3(c)(1) fund, it's one of these funds that can be sold to 100 investors without registering as an investment company, there the threshold seems to become the qualified client definition, which is a $1.5 million net worth requirement.

What happens is the QEP definition falls somewhere in between, so that when you're designing it, an unregistered fund product, if you are going to be a fund that relies on SEC Investment Company Act section 3(c)(7), you basically subsume the QEP definition and it doesn't become an issue, and it's that zone when you're doing the more, I guess the more common hedge fund, that doesn't have quite that same sophistication requirement, where you get the clash between the $1.5 million net worth and the QEP requirement, and it is in that area if there could be some way to reach a common ground that I think it would be very helpful.

MS. THORPE: Anyone else? Marianne.

MS. SMYTHE: Thank you. I am a grandma.

[Laughter.]

MS. SMYTHE: Isn't the issue -- I guess I think of the issue of reconciling these different standards really to need to fall back on why the standards exist in the first place. They are there to protect investors, and as I think Emily said so well, they are there because the only proxy we have for sophistication is money. We don't give investors IQ tests, and we figure that somebody who is rich can also afford to pay an advisor to help figure this stuff out.

I have been concerned -- I am speaking, by the way, for myself right now, I think, when I'm not addled in my old age. I think that the concern I have for the standard is only that the accredited investor standard now reaches the retail level, and people who just manage to live in their house for a sufficient period of time are now accredited investors, and I guess what I would hope for is that the agencies would address the issue of who should be protected by the laws that these standards exempt some people from and bring them up to the year 2002, and in the course of doing that, reconcile the level so that you don't need a score card to remember which acronym goes with the type of pool, but really to just assure that the retail

public gets the benefit of the protections of our laws, and those who can fend for themselves and who don't need the protection can benefit from taking different kinds of risks.

Sorry I talked so long to say that.

MS. THORPE: Rick.

MR. PRINS: I would echo Marianne's thoughts, and speaking personally, it has struck me for some time that the accredited investor definition is way too low of a buyer, and on the other hand, QEP is probably more than you need, and maybe there is a way to create a uniform definition that focuses not on income and net worth, which doesn't necessarily mean a lot as to sophistication, but rather how much you have in the way of investments that are in intangibles, whether they are securities or something else, but intangibles, so your house doesn't come into the picture. And whether that number is $1 million or whether it's $2 million, I don't know, but somewhere in there in focusing on investments, I think you would do much better at separating who ought to be protected by these statutes and the retail side versus those who really don't need it.

MS. THORPE: Jack.

MR. RIGNEY: Thank you. I'm Jack Rigney of Seward & Kissel, partner. We do represent a lot of private investment partnerships. I do agree with the comments of Emily on the overlapping design of definitions, and I would support Emily's approach in starting with the accredited investor definition and perhaps modifying it in certain instances.

I do think a lot of these issues, though, will be addressed when we get to 4.9 because there is a distinction between those people who could be exempt from commodity pool registration and investors who are eligible under disclosure exemptions, and I know we haven't made that point yet because we're going to be turning to that, but I do agree in terms of their harmonization and industry, SEC, CFTC approach, accredited investor definition is well understood, seems to work in the securities fund setting, so we endorse Emily's approach, with select modifications, perhaps starting with the accredited investor definition as a base.

Thank you.

MS. THORPE: Okay. Yes, David.

MR. VOGEL: I'm Dave Vogel from CitiGroup

Alternative Investments, and I have been involved in the managed futures business since the first managed futures public fund generated. I have a very long perspective of this investment vehicle, and I have to disagree with some of my panelists around the table. I'm not a lawyer so I can be allowed to not quote statutes and laws.

There has been some discussion about the level of sophistication or wealth needed to be accredited, and it brings me to one of my pet peeves or things that I'm concerned about in the business as we function on a daily basis, and that is when we receive comments back from regulators, it seems to be that they perceive this asset class to be much more volatile and risky than it actually is. And a consequence of that are comments about we should raise the requirements for people to be accredited or to invest in this area, and I often wonder what people are thinking of when they ask some of the questions they ask. It betrays to me a lack of knowledge of the underlying asset class. So you begin to question and think about what are the criteria that people are using in the regulatory scheme on a day-to-day basis when they review documents and look at investments as to what

the actual performance of these asset classes are.

I would guess that no one in those roles could tell you what the volatility of a managed fund vis-a-vis the volatility of the S&P 500. They're about exactly the same. The risk parameters are very, very similar. The return parameters are very similar.

In our firm we have 24 publicly offered funds in which none of our clients invested in them is losing money. Every one of them has a profit. There's not many asset classes that could think that.

However, when you go into these definitions and these regulatory reviews, the comments and the things that we are forced to do in our prospectuses are very uneven for similar asset classes. And I would call on the CFTC and the SEC after 20 years of doing this to take a look at this asset class that they're regulating, look at what its performance has been over the past 20 years, look at what the volatility and the risk to clients have been, look at the experience of the clients in public funds as a basis to make some of these decisions going forward.

We seem to use the word commodity in a bad

way, and therefore we carry forward with it assumptions that this asset class is not appropriate for some people. I would argue that it is appropriate for most people, especially in a public fund environment. So I would really recommend that prior to changing these requirements for suitability that we look at the actual 20-year performance of this asset class.

MS. THORPE: Yes. Paul.

MR. ROYE: I think David makes a fair point, and I think that, you know, one of the things that Chairman Pitt has emphasized is, you know, more focus on economic analysis in terms of analyzing issues like you raise, and factoring that into regulatory decision-making.

I would point out, however, that, you know, you're talking about definitions that are not simply used for your asset class. They are used in other contexts, and that may raise a whole other set of issues as to whether or not there should be separate definitions for separate asset classes. But I just would point out that, you know, that definitions like accredited investor are used outside their asset class and, you know, they are applied broadly, and, you know, maybe that's not

appropriate. But, you know, as these definitions have evolved, you know, they have been applied across the board and when you get into, you know, having to, you know, raise issues about changing definitions, raising limits -- and Karen and Marty probably have a better perspective than I do on this -- is that there are a lot of constituencies out there, you hear from a lot of people. There are small business groups that would argue against Marianne's position in terms of raising the limits because they view those limits as appropriate, and they want to raise capital for, you know, small venture operations.

So there are a lot of considerations here, but I would just point out that again that these are definitions that are used in a broader context.

MS. SMYTHE: I'm not trying to have the last word, but maybe I'm -- the question of the standards or the threshold is not designed to protect investors from investment risk, and I think, David, you were addressing your remarks to that.

The threshold really is designed to provide investors with other protections, i.e., the protection, for example, of the Investment Company

Act, which has a lot to do with it, but it doesn't have anything to do with investment risk.

The protections of the commodities futures laws and the securities laws are really never, have never been designed to prevent investors from taking investment risks. They are designed for other things, to give people disclosure, to provide some government oversight in the form of inspections. That's really to me what those laws are there to address, not investment risk, which I mean I would agree with you, how a, you know, a small cap, micro cap mutual fund that invests in Outer Slobovian securities is a less risky investment than what you manage is not the issue. It's the level of disclosure, the level of government oversight that is sort of almost, excuse me, but a grand paternalistic view of what the law does for investors who are below a certain level of sophistication.

MR. GAINE: I'm not even a grandfather yet, although I'm about two weeks different in age from the grandmother.

Rick, your idea, we went over, when 3(c)(7) was being considered, we went over what is the right standard and thing, and I say this, I

think on a clean slate, to raise that issue is probably a good idea, and maybe as a long term project, and long term I probably will be a grandfather and retired by the time it gets done. That strikes me if we throw out our existing system, you know, we don't go a route something along the lines of Emily, I think we have a really long term project which probably should be undertaken, which, quite frankly, David, your concept, if you read the Journal this morning about hi tech registered funds, it didn't paint a very pretty picture.

So I don't think it's government's business to really put people into or out of investments but, you know, high risk, risk and volatility in these things are measures, Sharpe Ratios and things, about which I know nothing, okay. You know, it's these factors which are going to determine the probability that an investor is going to be separated from his money.

Now, Marianne, you bring a traditional legal approach, and I think for today's discussion we should stick with it, because we haven't got time to change all these other changes, but I think what David raises as well as Rick, I think there

are some ideas that are well worth kicking around for future generations.

Thanks.

MS. THORPE: Thank you very much, Jack, and we do need to move on to the next topic. But I think Ken, you know, brings up the most important issue as to why we are having this discussion. These definitions have regulatory costs and have a major impact on how the pools are formed and who can participate and what the pools actually trade in, these investment vehicles. So it may be difficult to go back to first principles at this point in time, and as Jack said, it may be a long term exercise that the two agencies may want to engage in, but I think the question is are there some things that we can do in the short term that might provide some regulatory relief all around.

Let's get at the second issue, which has to do with the definitions of commodity trading advisor and investment adviser under the CFTC and SEC requirements, and where there is one potential area where the SEC's rules are to provide -- may take a more rational view as to who is required to be registered and who is not. Jack. Please.

MR. RIGNEY: Thank you. I have been asked

to comment on the dichotomy between the CFTC regulatory approach and the SEC regulatory approach, which I will attempt to. But it hinges on the 15 or fewer client exemptions which provides an exemption from the relevant adviser registration, investment adviser under the SEC rule and the commodity trading advisor under the CFTC rules.

Both exemptions read basically the same. Fifteen or fewer persons, if an adviser provides advice to 15 or fewer persons for compensation, that adviser would be exempt from registration.

The difference in interpretation, though, is a great one. The SEC has a rule which in substance allows an entity to be counted as one client if the advice is directed to that entity, and it does not look through that entity and count each equity owner of that entity as a separate client, which, of course, makes a huge difference. Obviously if you had a fund with more than 15 investors and you looked through them, that adviser would be required to be registered. That rule has been well understood and worked for years, and I think the industry is comfortable with it.

The CFTC approach I guess historically has

been to look through an entity for commodity trading advisor and thereby count each of the equity owners of that entity such that a fund that has more than 15 clients that's managed by a commodity trading advisor, that commodity trading adviser would need to be registered, presumably.

In practice, it doesn't -- it's not as huge an issue as the issue we just discussed because in a lot of cases, what we see on the private fund side, the adviser to that pool is a commodity pool operator and is already registered. But it has created confusion over the years, I'll say that, as long as I've been doing this. I have had a hard time trying to pinpoint where the CFTC interpretation came from. It's always been understood, I've questioned it on a friendly basis when I've spoken to various staff members over the year, and quite honestly, I could never find it. And when I had associates look for it, it was very difficult to find support for that position. So that's an administrative issue in terms of the perceived confusion about the standard.

A lot of practitioners in the business don't know the rule until you talk to the CFTC staff. But I do know that, I have had many

conversations over the years.

But what I just found out, though, apparently, is that the CFTC position stems from a 1979 Ninth Circuit case, I believe called CFTC v. Jack Savage, which I read, and I'll admit for the first time just two weeks ago. And I'm not going to go through all the facts of that case.

But what that case turned on, in my mind, is that there was a commodity trading advisor who was providing advice indirectly through another individual who had separate managed accounts. To me, that is a huge difference, separate managed accounts versus a fund, which just acts as a unit.

So I can certainly distinguish the facts, not that anyone is here to go through that case, but when I read that case, I still have some doubts as to what the merits of the position are with the CFTC approach, and certainly would endorse the SEC approach that if a fund is traded as a unit, the adviser does not know who the clients are in that fund, is not directing advice for the benefit of any of those individuals, therefore it would seem to me a very logical conclusion -- and I do believe that the SEC approach has it the right way -- that that adviser should be dealing with that fund as

one client.

So that's my spin on that issue. Thank you very much.

CHAIRMAN NEWSOME: Jack, would you mind enlightening us where this CFTC interpretation came from?

[Laughter.]

MR. GAINE: Yes, I have good news. A Governor Pataki --

[Laughter.]

MR. GAINE: -- just to stay relevant, yesterday signed legislation amending the Martin Act which confirmed that 203(b)(3)(1) will apply within the State of New York. This is the right thing to do.

Now let me go back to Jack Savage. When you are a young lawyer, you are not as smart as after you have all your experiences. Jack, if you look at the briefs in the Ninth Circuit, you are going to see the top name there of general counsel, John G. Gaine. But today you are looking at a much wiser, more experienced general counsel.

[Laughter.]

MR. GAINE: I agree with your analysis, and I have not reviewed it all, but the Savage case

involved individual advice to individuals at an FCM, and Savage argued we are only advising the FCM, if I recall, we are not advising the individuals.

But you know what? Jack Gaine of the CFTC was right. They are separate clients. To take a limited partnership, a juridical entity, a separate entity, only one person is being advised. The application of the Savage doctrine along -- and I left in '81 so I take no responsibility for whatever occurred after that. But I agree, on a legal analysis, the SEC is absolutely correct in their view. Governor Pataki and the assembly and senate in New York is absolutely correct, and there is only one client here.

As much as it is convenient to extend your jurisdictional reach, et cetera, to look through, it really makes no sense. I mean is a pension fund, you know, 700 clients? It's a limited partnership. Limited partners have no investment there. Their ears are plugged because they can't do a thing.

In other words, I agree with you, and if need be, I'll confess error in the Ninth Circuit and probably be disbarred. And that's all. Thank

you.

MS. THORPE: Now that Jack has seen the light, any other comments? Dan.

MR. DRISCOLL: I'm Dan Driscoll from NFA, and I would just like to point out that in that sort of exemption from being a CTA, it's not only 15 clients, but you can't hold yourself out to the public as a trading advisor, either. And frankly, I think that why some of these interpretations come up, it's because commission staff, probably including myself when I was back working during Jack's time, you see situations where bad people try to devise situations where they evade regulation and get in under some sort of loophole. And so I have no problem viewing a fund as being one client, and I really think if you saw somebody out there like Jack Savage, who tried to put together 14 funds with several hundred retail investors in it, that you could get him under holding out to the public as a trading advisor.

So I think there is ways to deal with that.

MS. THORPE: Any other comments on this issue?

MR. GAINE: In New York, this -- Dan's

point about holding yourself out was extremely important to -- I think his name is Elliot Spitzer and his staff as to why this 203(b)(3)(1) should be preserved. There obviously is a boiler room fraud problem here, but I think it's corrected by holding yourself out, which, you know, depending what jurisdiction is interpreting it, you know, it could be a listing in a phone directory or whatever. But, you know, it is a very stringent test, so.

MS. THORPE: Paul, you had a comment.

MR. ROYE: I may go ahead and get myself in trouble here, but since no one is going to defend the CFTC rule as it exists, and we have a different approach, I mean I guess would just -- you know, as I have thought about this issue, you know, you think about the de minimis exemption in the Investment Advisers Act, you know, why is it really there? You know, 14 or fewer clients, you know, what did Congress have in mind when they put that in the statute?

And you look at NSMIA, where at least in our area, where the SEC has jurisdiction over large advisers, any adviser that has over $25 million under management, we regulate small advisers that register with the states. And then you look at,

you know, some entities with indeed hundreds of millions of dollars, in some cases billions of dollars, you know, it may be one client, but the question is, is there a Federal interest in regulating advisory operations managing assets of that size.

So, you know, it is a question that I just throw out there, but, you know, what was intended with these small exemptions. We both are taking different approaches to it. There is a theory, there is an analysis that could get you to the CFTC approach.

MS. THORPE: Thank you very much. Are there any additional comments on this issue?

Okay, if not, then why don't we move on to topic 3, which is the disclosure issue, communication with prospective participants. The first topic under this section will talk about the fact that both the CFTC and the SEC review disclosure documents for publicly offered pools, and to the extent that there is duplication, then to the extent that both agencies are looking at the same items for the same purposes, are there areas where we can make that process more efficient. And we have asked Steve Olgin to lead off on this

issue. Thank you, Steve.

MR. OLGIN: Thank you. Chairman Newsome, Commissioners and staff, I commend the CFTC for setting up this roundtable and greatly appreciate the opportunity to appear today.

Under the able leadership of Chairman Newsome, there has been very healthy dialogue between the CFTC and the Managed Funds Association, and increased participation in a number of very important initiatives. I would encourage a continuation of this healthy interchange between the regulators and the regulated, and offer my continued assistance.

On June 6th of this year, I had the great honor of testifying before the Commission in connection with its study on potential changes in the regulation of intermediaries pursuant to section 125 of the Commodity Futures Modernization Act.

In that testimony, I made seven recommendations related to CPOs and CTAs, offering managed futures and hedge fund investment vehicles.

In preparation for this roundtable, I prepared an outline lifting from my prior testimony. I would respectfully request that those

remarks be submitted for the record. In the interest of time and recognition of the many participants and issues to be discussed, I will focus on just four issues, which I will mention very briefly, all of which are recommendations to rationalize the regulation of publicly offered commodity pools.

The need for rationalization is simple. It's really, as Jane mentioned, the duplication and burdensome regulation imposed on these vehicles is very costly, all of these costs are generally borne by investors, without any incremental investor protection benefits. And over the past 15 years, it has had a very chilling effect on the industry.

My first recommendation addresses the two Federal agencies, and I would recommend that they focus on their respective areas of expertise, and exempt pools from inappropriate S-K disclosures. Clearly the SEC is expert in the offering process, and they should continue to, all public pools should continue to be subject to the offering process and regulations at the SEC.

The CFTC, however, is expert in commodity pool disclosure, and all public pools, as private pools, should be subject to the CEA and its

regulations.

I prepared, along with some assistance, a grid that shows the regulation S-K and the Commodity Exchange Act rules, and how they apply to public commodity pools.

I would suggest that the staff evaluate that as they consider this going forward. Clearly regulation S-K, as Paul has alluded to, many of the SEC regulations were designed not with commodity pools in mind, but with operating companies in mind, and as a result of the growth of the commodity pool industry, I think it is time for recognition of that fact, and have each agency focus on their respective expertise.

The second issue relates to exempting public commodity pools from '34 Act reports. Most '34 Act reports, either 10-Ks or 10-Qs, are either not applicable to commodity pools, but primarily to operating companies or redundant of more appropriate CFTC regulations which require more frequent, generally monthly rather than quarterly, disclosure, and direct rather than indirect communication to shareholders and investors.

On the open end investment company side, which permit redemptions in a similar fashion to

commodity pools, those vehicles are not subject to '34 Act reports, but are governed by the Investment Company Act, and I think some consideration should be given to whether or not public commodity pools should be exempt from the '34 Act reports in deference to the reporting requirements under the Commodity Exchange Act.

A third area is an expansion of the Federal preemption provisions of NSMIA to include public pools. As most people around this table know, public commodity pools are subject to 50 different State regulations if they are registered in those States. The costs and burden associated with clearing a public commodity pool in 50 States is incredibly high. All of those costs are generally borne by the investors, without any incremental investor protection benefits.

I would suggest -- this has been a topic of concern for the industry for many, many years, even before the Savage opinion, and that's something that I would suggest that we seriously consider how we can address that.

And, finally, I know it's the next topic for discussion, so I will only briefly mention it, is to conform the CFTC to the SEC prospectus

delivery requirements for public commodity pools.

As far as I know, pools are the only investment product in the United States that is required to deliver a final prospectus before any direct or indirect solicitation. This results in a significant increase in cost, again without any additional investor protection benefits, because investors must acknowledge receipt of the prospectus before actually investing, which is also different than many other securities offerings.

Again, the SEC is the expert in the public offering process of securities, and their role should govern in this context, and I would recommend that the CFTC evaluate that in its deliberations.

As a final note, it is great to see the cooperation between the SEC and the CFTC, and I would encourage a continued cooperation between the two staffs of both agencies to rationalize the regulation of commodity pools, which would serve to better utilize both the limited resources of the Federal government and the increasingly fewer resources that are also available in the private sector.

I would be eager to answer any questions

that you have.

MS. THORPE: Thank you, Steve.

Do any other participants have comments on the issue?

Yes, Teresa, yes.

MS. BECKS: Hi, I'm Terri Becks with Campbell & Company. I am the chief financial officer of Campbell & Company, and we are a commodity trading advisor. We are also the commodity pool operator for Campbell Strategic Allocation Fund. It's probably, I think it is, the largest publicly offered futures pool right now. And I do not have the eloquence of the other attorneys here, but I am one of the grunts who is involved in putting these things together. It's a continuous offering.

We need to update the offering every nine months, at a maximum, assuming there's no changes in disclosures. But we probably have to start the process about four months prior to that nine-month effective date that we're shooting for, because we do have to file with the SEC, the CFTC, the NASD, and all 50 States, and we typically do get comments from most of the regulators that we are filing with.

It is frustrating on our side, but we also realize that it is frustrating on the regulator's side. The SEC, for an example, as Steve had pointed out, a lot of the rules apply to operating companies in these public disclosures, and I have had very intelligent dialogues with the SEC, both of us trying to help each other, how do we get this public pool to fit into these requirements that they are trying to carry out.

So I do agree with Steve on how a lot of these changes should be made. The CFTC has created a lot of rules for determining how to disclose what we are doing, and the operating requirements for our funds. The SEC, at the same time, is very well versed in public offerings, and we would look to them for their comments on that. But if there would be a way to give different regulators their different parts to review.

We do end up, a lot of times we'll get one comment from one regulatory body that conflicts with the comments of another regulatory body, and we end up kind of trying to play mediator between the two in getting our documents done. The problem there is it makes it very cost-prohibitive.

We are very happy to be number one. We

would also welcome other participants to be able to provide the same pool offerings that we do. We are in a very fortunate place, but we would like to see other people join us. In the futures industry, we actually welcome competition because it just produces more of a presence in the public about what we actually do. But we feel like the way the regulatory structure is set up right now, it really does eliminate the ability for other people to compete with us.

Thank you.

MS. THORPE: Thank you very much, Terri.

I think, George, you had a comment.

MR. CRAPPLE: It's somewhat in the same vein. My firm, Millburn Ridgefield, also sponsors public as well as private futures pools, and I was interested in Karen Garnett's comments that they don't see too many at the SEC, too many S-1s coming through. There are reasons for that, and Terri alluded to quite a few of them.

I mean you have to have $400,000 or $500,000 to even undertake such a project, and people around the table, Dave Vogel from CitiCorp and Steve Olgin from Merrill, who have shelled out

this money many times at Campbell, and we have as well, so it is quite an undertaking financially to put a fund out in the marketplace.

But another consequence of that is it's so costly there aren't that many, so when one comes in to the SEC -- and, of course, you have a lot of examiners who are -- you know, they're moving through and up and they've never seen it before, more often than not, and as you say, Terri, every nine months we are updating, and we have open-ended funds. So when you're updating, you update all your numbers, you send your amendment in, and you get another 60 comments. How can this be?

The way this can be is there's a whole new group of people looking at them and they're trying to puzzle through all of the SEC requirements that maybe apply to General Motors, and that don't fit too well for our futures pool. So I think there is really a lot to be said in this time where there are plenty of places where SEC resources can be well allocated, as well as CFTC resources, and I think it would be very much in the interest of our financial system to divide this up in a rational way, so resources can be freed up, say, in the SEC's case to, you know, pursue the many areas that

really need pursuing these days.

MS. THORPE: We have some other comments here, and perhaps you would like to wait to comment, Karen, until you hear from the rest of the industry representatives.

David. Yes.

MR. VOGEL: Thank you. I agree with everything that the two preceding speakers had said. I would just like to bring into a little clearer focus what it means. We are in the process right now of coming with a new public offering.

The hard costs that we pay out are half a million dollars, minimum. The soft costs are the time of the people involved over this four-month period and all the effort that it takes is about another half a million dollars. That's $1 million of costs before we can even market to a client or be involved in any type of premarketing or any type of expectation as to what the results of our investment would be.

But I think the key thing is that has been mentioned or alluded to, there really are only about three CTAs that I know of who are big enough to put together their own public offerings and keep them updated, and there are about four firms that

do it.

This has resulted in -- this is not the best thing for me to be bringing up -- but a very noncompetitive marketplace. There is no competition. Therefore, there is little incentive on people to be as efficient as they might be. The costs are all out of relationship to the benefits that the client receives from all these regulations, and as long as this system of multiple jurisdictions and endless filings and comments and costs go on, you will not see -- the mutual fund complexes have not entered into this. About the only thing they haven't made a mutual fund on is managed futures because it's so difficult and so costly, and without an understanding of what it could do for the clients and how they may recoup their costs, there will be no competition in this area. And I think competition -- I agree with the spokesman from Campbell, we welcome the competition. We think it would be better for our asset class and industry if more people were involved in this, but under the current regulatory statute, you're only talking seven or eight firms who are really going to be active in this area, and I don't think that's in the investors' best

interest.

MR. GAINE: Terri and George and Steve and particularly Steve and I go way back. He knows this issue and he does very, very well. I do want to say, George, when you were at Sidley receiving those fees, did you feel the same way?

[Laughter.]

MR. CRAPPLE: They seemed much more reasonable then.

[Laughter.]

MR. GAINE: And for the record, Paul Roye smiled at Mr. Vogel's remarks about a mutual fund. But I think the issue, SEC, CFTC, and let's not call it an issue, but the harmonization efforts that hopefully we are going to leave here to undertake, is really, really important.

What is truly absurd is that you have not only a full panoply of Federal regulation of a vehicle here, but you probably have duplicative panoplies of Federal regulation, and you still have Tennessee stickers and Iowa stickers, and I think to get together -- and I'm not sure, but I think it would take Congress to make a couple of changes. We were in -- you talk about anti-competitive, David, in the field in NSMIA back in '95, there was

preemption for the futures funds, and there should be, should have been. It was a, to put this euphemistically, a pure competitive issue, it was taken out, okay? So we are saddled with the state issue.

Now it's different from this Federal issue, but it's just so patently obvious to us that the state preemption here should be done that I hope we would all agree on that.

Thanks.

MS. THORPE: Thank you, Jack.

Any other comments? Steve?

MR. OLGIN: Yeah, if I could just add one thing, that maybe touches a little bit on what Dave was saying, and to give a little more commercial perspective of what the impact has been to my firm and to our clients.

I am the chief administrative officer of MLIM, LLC, and we have four different product lines in the alternative investments area that we offer to Merrill Lynch brokers, who then offer them to their clients. Exchange funds, hedge funds, managed futures funds, and private equity funds.

We have not undertaken a new publicly offered managed futures fund since 1996, and the

reason we haven't is because of the costs associated, both the hard costs, as Dave said, and the resource time that is spent by, you know, our team to build that and sell it.

So what has happened is to Merrill Lynch's clients, these products, which provide very, very significant noncorrelation benefits, especially during the past three years, the U.S. investors are generally not able to receive those types of products because what happens is firms, such as myself, decide how they want to allocate their resources. It is far easier to put together a private placement on an offshore fund of a managed futures product and sell it to those clients, and then that leaves the investor that would be eligible to buy a publicly offered futures fund, at least at Merrill Lynch, with very few alternatives.

So what has happened is the overregulation and the burdensome regulation has really impacted what clients are able to receive from a product line, and I think it is very, very important for Washington to understand that, because the cooperation between the two agencies, I think, will go a long way to improve that.

My firm was involved in the pilot program

with the SEC on Plain English, and Marty Dunn and the Plain English task force at the SEC were very, very cooperative with us in getting that through. And we actually thought that that was going to bring a new beginning to this industry because there would be a template, there was more harmonization between the regulators on that process, but it really hasn't happened, and hopefully this forum will kind of reinvigorate that dialogue between the two agencies.

Thank you.

MS. ZEIGLER: Just a brief comment. I, of course, agree with everything all of you are saying. Just as to legal costs involved in these things, in case there are people here who don't know, a typical public fund could cost in legal fees alone $200,000, and a private fund, a private futures fund, essentially the same fund, it could have the exact same managers, would probably cost 50. And it's a direct result of the fact that the SEC, CFTC, and the NASD, and all the States make all these comments and compliance just has to be done.

It is not because the prospectuses are very different one from the other.

MS. THORPE: Ken.

MR. GERSTEIN: I'd just like to follow up briefly on some things that Steve said about the noncorrelated returns. It's something we're seeing on the investment, registered investment company side. In terms of a lot of new types of hybrid products, particularly when we are dealing with volatile markets, uncertain markets, where people are trying to innovate and develop products that are designed to help investors through these kinds of markets.

This sort of, I guess, goes back to something we really skipped, which is of interest to me, which was under II. B. relating to, I guess, rule 4.5, but how this also comes into play the same way, why we don't see investment companies that are also pools, where if they could be and they could have greater use of futures, we could see more types of products which try to introduce types of asset classes to achieve different types of noncorrelated returns.

MR. DRISCOLL: I just wanted to say that five years ago, the CFTC delegated to NFA the responsibility to review all CTA disclosure documents and the disclosure documents of privately

offered commodity pools. And we weren't delegated the responsibility to review public pools. I just want to say today that we would love to have that delegation and we love to work not only with the CFTC, but the SEC, to work out both the process and the standards under which that review would be done. And certainly submit ourselves to reviews by both agencies of how we do that work.

MS. THORPE: Thank you very much, Dan.

Bob Paul.

MR. PAUL: Thank you, Jane. I know that Steve showed me that microphone worked. I thought I'd better use it for myself as well.

I am Bob Paul. I'm general counsel of OneChicago, and before that I had the privilege of being general counsel at the CFTC, but before that, for a number of years, I was at Dean Witter, and reading the submissions of Terri Becks and Steve Olgin brought back all the nightmares of my years looking at the managed funds that Dean Witter sponsored which, along with Merrill Lynch, were among the most active and most distributed in the country.

What I am starting to hear is that things haven't gotten much better in the last five years,

at least with respect to the duplicative and triplicative regulation. I think -- and I agree with virtually all the comments.

I do want to stress the importance of what both Steve and Jack said with respect to the need for Federal preemption. As expensive as it is to deal with both the SEC and the CFTC on these disclosure documents, that cost is multiplied 50 times in dealing with the State regulators. And they do have comments, and you have to make special arrangements and customizations for each of them.

I think it is important to emphasize that the ultimate loser in all this is obviously the investor. As Emily points out, and David, the cost to the funds is substantial, and that money should be invested in the funds and should be earning returns for the investors, rather than being used to pay for redundant regulation.

I think that from my experience working at the CFTC with the SEC, I think it is absolutely crucial that Paul Roye and Karen Garnett are here. There is obviously good progress in these agencies working together, and I am sure that with the inroads that they've made on security futures, in

coordinating that, they'll find a solution to lessen the burden for the funds.

Thanks.

MS. THORPE: Thank you very much.

Pat.

MR. McCARTY: I feel honored to follow Bob Paul, my immediate predecessor as the general counsel.

I just have two quick questions. Emily Zeigler threw out a cost on doing, I guess, private futures fund versus a public one, and it was a difference of $150,000. I just wonder whether we can put out on the table what the cost of actually a new public investment company mutual fund would be, so we have some way of measuring things.

And I guess the second question I would ask, just sort of pointing down towards Dan Driscoll at NFA, I guess the number of commodity pools that you review the disclosure documents of, and you said that it's just the private ones as opposed to the public ones, but -- and I guess the number that you review and -- do you do a 100 percent review of all the disclosure documents, or do you do just a percentage, or how do you do that?

MR. DRISCOLL: We review every document

that comes in, whether it's an initial offering or an amendment or an update. So we review each of them completely. And we have a group of specialists that that's their jobs. So we are able to obtain quick turnaround as well.

MR. McCARTY: The number?

MR. DRISCOLL: In the last year we reviewed over 2000 disclosure documents, and I think, if our records are correct, that we received five public pool documents. So certainly there wouldn't be a -- if we were given that responsibility, it wouldn't be resource-intensive for us.

MR. McCARTY: Emily, do you have a number for me on legal costs for investment companies, public and open-end funds, or anybody?

MS. ZEIGLER: We have to ask somebody who actually does that.

MR. PRINS: This is Rick Prins. I think three things. A closed-end fund, which are stand-alone and it's a public offering, often underwritten, where you have to deal with underwriters, is probably the most expensive of the variety, and they may run $100,000 plus or minus.

Starting up a new open-end fund is

somewhat less than that, but could run that much; not usually.

But opening up a new series, to have a new kind of portfolio of an existing open-end fund, is often only $20-30,000.

MS. THORPE: Thank you.

Karen, I believe it's your turn to provide some comment. Thank you.

MS. GARNETT: I'll start off by saying wow. That's a lot to follow up on.

Also I omitted my disclaimer earlier, so I should give that now, that my remarks are strictly my own and do not represent the views of the Commission or its staff.

I will try to address a few of the points that have been raised, but on a more general level, you know, I think we certainly recognize that there is some duplication between the information that's required under the CFTC rules and the information that's required under regulation S-K, and I think the way to achieve a more efficient system for disclosure review is not to just give up on one, but try to better harmonize the two systems that we have in place.

I think the CFTC rules are -- have their

own purposes, and as many of you have pointed out, are very specifically targeted to commodity pools and the very specific issues that arise in that context.

The SEC rules, on the other hand, have a different purpose, have a broader purpose, and we believe that both of those are legitimate and that the disclosure can be harmonized in a way that doesn't result in a lot of unnecessary duplication.

I guess as a starting point on regulation S-K, I disagree with the view that S-K is intended strictly for operating companies. I believe S-K is written in such a way as to address any company that would do a public offering. Commodity pools are not the only limited partnership public offerings that we see. Certainly we see lots of them in the oil and gas industry, we see lots of them in the real estate industry, and I think real estate in particular is somewhat analogous to commodity pools because a lot of REITS operate similar to investment companies in the sense that it's a vehicle that investors can choose to diversify their portfolio.

We have over the years developed a way of addressing those particular industry issues,

whether it's commodity pools or oil and gas, or real estate, in a way that achieves the disclosure purposes of S-K, but also recognizes some specific industry issues.

I don't think that commodity pools need to be treated any differently. I think we have managed to find ways to address specific industry issues.

One of the -- I think in a number of areas, there probably is duplication and we welcome the CFTC rules, frankly, because we think the CFTC rules do better address the specifics of commodity pools than we are able to do.

In many instances, if not most, the CFTC disclosure satisfies the S-K disclosure requirement. So I think as we go through the comment process, it's not a question of, well, here's this S-K requirement that's not addressed by the CFTC, so here's some more disclosure that we want you to put in.

That happens some, but I think more often than not, our comments are geared more toward clarifying the disclosure that is presented in the Securities Act prospectus, as well as the presentation of that disclosure.

Our Plain English initiative addressed some of that, but going back before Plain English, I think historically our disclosure has been -- our disclosure review process has always focused some on where information appears in the document. And a lot of the comments that we tend to raise, not just on commodity pool offerings but on any offering, have to do with where material information appears in the document, and so we will raise comments on that.

I don't think any of these are issues that are particularly difficult to comply with. I'm sure in any particular filing, there may be a handful of issues that are difficult to resolve, and those do take some time, but I think by and large the disclosure review process is fairly well harmonized with the CFTC disclosure.

As I said, we do recognize the value of the CFTC disclosure, and have relied on that, really, in satisfaction of the S-K disclosure requirement.

One particular example that I would give in that regard is the prior performance disclosure that we require. The CFTC has developed its own very specific and very relevant disclosure

requirements for prior performance that differ somewhat in format and presentation and content from prior performance that we might require from other limited partnerships. We have traditionally accepted the CFTC disclosure as achieving the disclosure goals that we have for other limited partnerships, but in a way that makes more sense for commodity pools.

That is, I think, the type of solution that we would like to get to, is harmonizing our review with the CFTC disclosure in a way that really makes sense for everyone, but without completely discarding the S-K disclosure requirements.

MS. SMYTHE: Can I say something?

MS. THORPE: Marianne.

MS. SMYTHE: When I was at the SEC as a very unworthy predecessor to Paul Roye, I had the invidious job of trying to mediate between the CFTC and the Division of Corporation Finance in my own agency on this subject.

Let me just ask you all a question. Where are the prospectuses reviewed for companies that want to register as investment companies? Are they reviewed in Corporation Finance or in the Division

of Investment Management?

MS. GARNETT: Investment Management.

MS. SMYTHE: Why is that?

MS. GARNETT: Well --

MS. SMYTHE: Don't answer. Well, I know the answer.

[Laughter.]

MS. SMYTHE: The answer is that they used to be reviewed in the Division of Corporation Finance, but no matter how hard one tries to harmonize between even two floors -- Chairman Breeden, when I was there, used to have a clock which showed the time in each division.

[Laughter.]

MS. SMYTHE: Even trying to harmonize between two divisions in the same agency, as I'm sure -- as I remember is the case here. In fact, Jack and I were here together, and it was my job to mediate between Jack and my boss, Tom Lochran, which was not easy.

Getting back to the point, though, it seems to me the issue is really quite clear. Commodity pools are within the purview and expertise of this agency, the CFTC, not the SEC. It is very hard for my other alma mater, the SEC,

to cede authority on anything, let alone something as central as this. But until there is a single reviewing entity for the registration of these products, I don't care how hard you try to harmonize and to acknowledge that the CFTC's performance reporting may be better than the SEC's, it's got to really be with the CFTC or it's going to work. That's my personal view, and I just hope sooner or later there will be a harmonization that does for the commodity pools what was done for investment companies when the Division of Investment Management took over reviewing.

And it was not a criticism of Corp Fin, although I'm capable of that. This was not a criticism of Corp Fin. This was really simply because it had to be done in one place.

MS. GARNETT: Well, I guess I'll respond, and I know Paul wants to respond as well.

Just to take a step back for a second, our interest is not so much in regulating commodity pools, but in regulating public offerings of securities. And it happens that commodity pools, when they make public offerings, they are selling limited partnership units, and those are securities.

MS. SMYTHE: We all know that.

MS. GARNETT: I know, but I'm just emphasizing that our interest here is not regulating commodity pools per se, but regulating public offerings of securities. Just like we would for any other industry.

MR. ROYE: Let me just make three quick points on this subject.

One, you know, we have been spending a lot of time looking at Sarbanes-Oxley, and if you don't know already, there are provisions in that legislation that require the SEC to look at every issuer every three years, to go through their disclosures, you know. So we have been mandated by Congress to be in this game and stay in this game.

Secondly, and I think as Bob alluded to, and others have alluded to, you know, we do have scarce resources. There's no question about that. We've got plenty of issues, just like the CFTC has, to focus on, and at least in my little world of Investment Management, where we are trying to juggle things and get things done, a lot of times we have the industry, you know, on issues like this come to us and say you need to revamp the form. We've had the variable products industry come in

and say you ought to do a separate form for variable life insurance and they have framed it out for us and it gave us a head start in terms of, you know, doing that new form.

Finally we did get that form in place, so I guess what I'm suggesting is we are looking for solutions here, that you're part of the solution, that, you know, to the extent that you have ideas, to the extent that you can put this in writing and say here's the way to harmonize CFTC regulation disclosure, SEC disclosure, and lay it out in a way that, you know, it makes sense and we can understand it and we can debate it, we're going to be further along. So that's one idea.

And then secondly, on Jack's point, I have seen the benefits of preemption. I worked with Pat McCarty years ago and we spent a lot of time trying to get registered investment companies through the States, and that was part of the cost. And guess what? Those preemption in that area, the issue has gone away. You still have to pay fees, because the States want their fees, but it really has streamlined the regulation of registered investment companies.

CHAIRMAN NEWSOME: Karen, I don't want to

put you on the spot at all, but based upon your comments and looking at the redundancy issue, as I understand it, the SEC does select review of filings?

MS. GARNETT: Yes.

CHAIRMAN NEWSOME: So if you have got a public commodity pool registration statement, it could receive a no-review. And my question is, and I'm just thinking in theory, if -- would it be possible for the SEC to consider policy that it would give the no-review to a public commodity pool if it's already been reviewed by the CFTC, or would that help the redundancy issue at all?

MS. GARNETT: As a general matter, any initial public offering by a company receives a full review; not always, but most of the time.

And so -- and I think most of the commodity pool offerings that we see actually do come in as initial offerings by those funds.

To the extent -- and I think one of the issues that we have had with Terri Becks is filing post-effective amendments to update those offering documents.

And, you know, certainly anything like that, any subsequent filing by an issuer that's

already out there in the market does go through our screening criteria, and we do -- you know, that is one of the things we take into account is have we looked at this company before.

Paul mentioned Sarbanes-Oxley, and I think that's going to have a significant impact on how we select filings for review, but -- and so that, you know, you may actually see looking at all companies more often than we have in the past, but, you know, certainly that is -- that's part of the mix already.

CHAIRMAN NEWSOME: I have one question for Steve.

In your written comments, I think both in June for this meeting and then in your oral comments as well, you talked about, or you make the point that, the marketing of commodity pools is difficult and more onerous than marketing other types of collective investment vehicles, due to CFTC regulations.

My question, I guess you believe, or based upon your comments, you would believe, that our rules are more onerous than the SEC in this area. So my question would be, if the CFTC changed its rules to be more in line with the SEC, would

investor protection be compromised in any way?

MR. OLGIN: I don't believe that it would because, keep in mind, the requirement is that you have to deliver the prospectus before any direct or indirect solicitation.

In commodity pools, investors must sign a subscription document acknowledging the prospectus, so there is no financial risk to the customer of him receiving a preliminary prospectus like most, you know, IPOs undertake. And he will not subscribe. When the final document is delivered, it then allows the firms to narrow down who is a serious prospective investor, and they will receive then the final prospectus. So you will save on printing costs, you will be able to more effectively market it, and investor protection will not be compromised at all because they still will sign an acknowledgement on the final prospectus that they receive.

If I could just make one further comment. Paul, it seemed to me that you were suggesting that it might be a good idea for more cooperation between the SEC and the CFTC, and I think it would be -- this is an issue that has been around as long as I have been doing this, when I started

practicing law in '86, and then when I came to Merrill in '94. It's a long time.

To the extent that the industry can put together a task force that works with the SEC and the CFTC to address these four or other issues, I offer my assistance, and I'm sure that some of my colleagues would do the same thing, so that we can finally move this forward and hopefully have some resolution.

MR. GAINE: Steve, you preempted me here because I was about to suggest to volunteer.

In addition to the mistake I made in Savage, I think one mistake I might have made in the late '70s was not to argue that the SEC, the exclusive jurisdiction provision of the Commodity Exchange Act, excluded the SEC from their '33 Act review of commodity funds. Well, I didn't. A lot of water has gone over the dam since, and I'm not making that point now.

But I would like, as Steve suggested there -- I mean as I understand it, I'm not -- I don't practice over there, but I think we are in with penny stock, oil and gas, and real estate, whereas there's a division over there that deals with funds that are much more similar pooled, collective

investment vehicles, much more similar to us.

Karen, I don't know how long you've been there, but what I'm doing is signing onto what Steve is, and I'd like to nominate Steve. He's been the most active and knowledgeable person in this area. I've been doing this for 10 years, and the stories I've gotten from a number of attorneys and a number of business people is not -- really isn't -- I'm not suggesting that you're wrong. It's been persistent complaints about the '33 Act registration process over at the SEC in one form or another. But this isn't the forum for that, but if you are willing, Steve is willing, we would like to put a group together with the CFTC and work with the appropriate people at the SEC and maybe come up with a solution.

But this has been a festering 10-year problem in my 10 years in the business, and I think Steve is saying the same thing there.

MR. OLGIN: I think, frankly, too much emphasis has been put on criticizing the SEC. That's what the SEC -- their mandate is, has been. That's what their job is. And until it changes, that's their job.

I guess what I'm trying to say is I think

now is the time to change it, and as the Chairman noted, there is a CFTC issue that could very easily, hopefully, change and improve things that would cede the authority on the offering process where it rightfully belongs, which is the SEC.

So, you know, in fairness to the Division of Corporation Finance, I think too much criticism has been leveled. That's the way it's been, that's something that needs to change, and if we put our heads together creatively, I think we can come up with a solution that really benefits everybody, it benefits investors, it does not compromise any investor protection issues, and it makes these products available to clients who really deserve to have them in the United States, not just outside the United States, and not just private investors.

MS. THORPE: Thank you.

I can't speak for what's happening at the SEC, Marianne, but I can tell you all of the clocks in all of the divisions at the CFTC are at the same time.

[Laughter.]

MS. THORPE: Okay. Well, we hadn't scheduled a break, but this might actually be a good logical time to take a five-minute break, and

if we could all be efficient and come back so we can cover the remaining topics. Thank you.

[Recess.]

MS. THORPE: We've been running a little late in our schedule, so we would like to start as quickly as possible on our next topic, which is the issue of when disclosure has to be provided.

George Crapple, please.

MR. CRAPPLE: Thanks, Jane.

I am just going to make one final remark on the prior topic. I'd love to send all of our public pool documents to Dan Driscoll at the NFA, but if we're not allowed to do that, it occurs to me that Paul Roye's department at the SEC is looking at investment companies that trade publicly traded securities.

What we trade in the futures pools are publicly traded derivatives on securities. It's really pretty close, and the mutual fund prospectuses are about the thickness of the legends that we put on our prospectuses. It would be tempting.

Well, anyway, my specific topic, which we have already discussed somewhat, is the CFTC rules requiring delivery of a disclosure document before

directly or indirectly soliciting a potential investor. And in deference to Jane, I'm not going to mention what those rule numbers are.

The rules apply to the solicitation of managed accounts and to public and private offerings of pools with the exceptions of offerings of interest in rule 4.7 pools to qualified eligible participants to whom the delivery disclosure documents don't require.

The rules also permit a CPO to deliver a shorter profile document containing specified information prior to providing prospective investors with the disclosure document. Because any other communication is susceptible of being interpreted as a direct or indirect solicitation, the rules effectively eliminate non-disclosure document communications unless accompanied or preceded by a disclosure document.

The questions for consideration at the roundtable include how do the CFTC rules compare with the SEC rules for solicitation of investors, and what are the CFTC rules intended to protect against.

So here we get to criticize the CFTC a little bit for a change.

In the case of public offerings of any security which is not an interest in a commodity pool, the SEC allows tombstone ads which may contain specified factual information. These communications are designed to locate potential investors who may be interested in the offering and

interested in receiving more information.

This limited sort of communication would be allowed for public offerings of commodity pools but for the CFTC rules. If this were an SEC rather than CFTC roundtable, I would advocate liberalization of the tombstone rules to permit factual, balanced, nonmisleading and nonfraudulent information.

The SEC rules also provide for the use of red herring preliminary prospectuses and delivery of the final prospectus with confirmation of an order.

The SEC has no specific requirements as to content or delivery of information in the case of private placements to accredited investors. Issuers have rule 10(b)(5) anti-fraud liability.

As noted above, CFTC rules do not require a disclosure document in the case of qualified

eligible participants in 4.7 pools, and the CFTC permits a CPO to give a summary profile document containing only specified information about a pool prior to the disclosure document.

Like a disclosure document, the profile must be filed with the CFTC before use. The profile seems quite heavy on notices, risks, and warnings, and light on the information which might help locate potentially interested investors.

In an effort to ensure that no good risk goes undisclosed, the profile is really a mini-disclosure document.

In a totally unscientific and nonrandom poll I have taken in connection with this roundtable, I failed to unearth any use of profile documents.

In any event, except for rule 4.7 pools, the rules governing private offerings of commodity pools are more restrictive than for the offering of any other type of security, and in a case of public offerings of pools, even the narrow tombstone advertising is prohibited.

What are the CFTC rules intended to protect against?

Is the prospective investor in a commodity

pool likely to be so swept away by preliminary factual, balanced, nonmisleading and nonfraudulent information that he will cast aside the disclosure document and sign the subscription agreement as soon as he can get his hands on it?

The drafters of preliminary marketing materials are not likely to be so eloquent or convincing.

Is there something peculiar to offerings of futures pools which requires more stringent rules than all other types of security offerings, such as being especially risky?

I think the bear market in stocks has laid to rest any idea that managed futures are more risky than equity, a point David Vogel made earlier.

The full panoply of protections offered to investors under the Investment Company Act of 1940, for example, leverage limits and diversification requirements, permitted mutual funds investing in nothing but dot coms.

There seems no rationale for singling out futures pools. When an investor receives the disclosure document before committing to an investment, there is no justification for different

treatment than other securities offerings.

What information should be allowed in communications which precede delivery of the disclosure document? My premise is that the information required in disclosure documents is generally useful and that preliminary information will be considered by the potential investor in the context of the disclosure document.

I would, therefore, propose that any factual, balanced, nonmisleading, nonfraudulent information about the offering of a commodity pool or account which is otherwise permissible under the Federal securities laws, be permitted. This would automatically result in separate standards for public and private offerings and set a core principles type of standard for managed accounts.

The idea of balancing language has long been required for disclosure documents and marketing materials and it can be employed usefully for preliminary materials. If the materials do not meet the suggested test, liability would accrue.

Communications which now often accompany the disclosure document are not normally subject to filing requirements, and I see no reason for prefiling materials which precede the disclosure

document. If they are unbalanced, misleading or fraudulent, the sponsor would be liable.

Of course, the discussion of preliminary communications assumes that a disclosure document will be delivered. In the case of public and private pools and managed accounts, a signature is required, unlike purchasing stock by calling a broker. The receipt of the disclosure document must be acknowledged in writing. There will be no question that the investor has had the opportunity to read the disclosure document before committing to the investment.

Whether it is actually read is no more or less knowable than in the case of prospectuses generally.

Modifying the rules would not change the rule that a disclosure document must be delivered and acknowledged.

In the case of registered investment advisers, under the Advisers Act of 1940, the adviser's disclosure document must be delivered at least 48 hours prior to entering into an advisory agreement.

Since there must be written acknowledgement of receipt of the pool or CTA

disclosure document and a signed subscription agreement, the 48-hour period seems unnecessary in this context.

What benefits would accrue to the proposed modifications of the rules?

One is regulatory. An increase in consistency between SEC and CFTC rules would be achieved.

A second is cost savings. Marketing expenses are normally paid by pools, and marketing documents are very expensive. The ability to obtain indications of interest in an offering before providing the main document would be a material reduction of cost to investors. This benefit can be achieved without any diminution of customer protection.

MS. THORPE: Thank you for that very comprehensive and informative statement, George.

Does anyone around the table have any views on George's issue? Chairman.

CHAIRMAN NEWSOME: George, I would just simply say point made. My assumption is you would answer very similarly to Steve the question I asked about investor protection.

MR. CRAPPLE: Absolutely.

CHAIRMAN NEWSOME: Okay.

MS. THORPE: Okay. Well, then, thank you for that, George.

Let's go on to a topic of more recent vintage, security futures. I'd like Susan Ervin to tee up some of the issues raised by security futures in the managed money area, and then I'd like to get David Harris of NQLX to raise some specific issues raised in the context of those exchanges that solely trade security futures.

We also have two other representatives from securities exchanges, securities futures exchanges here as well, Bob Paul and also Chris Concannon of Island, so they are well represented here today.

Susan.

MS. ERVIN: Thank you. My name is Susan Ervin. I'm a partner at Dechert, formerly on the CFTC staff. I have an extensive practice in hedge funds, managed funds, and security futures products.

Well, at this point, some time after the enactment of the Commodity Futures Modernization Act, we are all excruciatingly aware that under that Act security futures are deemed to be both

futures and securities. And commodity professionals who transact in these products are potentially subject to dual regulation.

Certainly those of us -- and I particularly include the agency staffs who are here -- are aware that the CFMA security futures provisions are a mountain of complexity. But I would suggest that a few points do emerge thematically that affect the issues relating to managed funds.

First, it is fairly clear that the underlying legislative intent was that trading interest in security futures be permitted to flow as freely as possible from both the securities markets and the futures markets, from the securities industry and the futures industry.

The Commodity Futures Modernization Act recognizes that characterizing security futures as both futures and securities has the potential to create an excess of regulation. Firms already in business as brokers or advisers, for example, might want to add this new product, security futures, to the mix of their activities, but they couldn't reasonably be expected to take on a whole new regulatory status in order to trade a single new

product.

So wisely, I think, the Commodity Futures Modernization Act created notice registration provisions for broker-dealers and FCMs under which both the registration process would be streamlined, and the actual regulatory requirements would be based upon the primary status of the firm, rather than simply imposing two tiers of regulation on the same entity.

With respect to commodity trading advisors and investment advisers, the CFMA gave even broader relief. Registered investment advisers whose primary business is not giving futures trading advice are simply exempt from CTA registration under the CFMA.

Similarly, CTAs whose primary business is not giving securities advice are exempt from investment adviser registration.

These provisions seem to be well designed. I know that some have made the comment that they could use some explication, that people are not sure what primary engagement means in this context, but essentially sound parallel provisions.

As applied to investment funds, however, the security futures provisions of the CFMA have

the potential to create some more draconian and harsh results. There is no parallel set of carve-outs as there are for investment advisers and commodity trading advisors in the fund context.

So what's the result? If you are a CFTC registered commodity pool operator, you can add security futures to your funds and you can do so if you are compliant with 3(c)(1) and 3(c)(7) of the Investment Company Act, without having to take on any new regulatory obligations.

However, as Emily and others have pointed out, if you are offering a publicly offered fund, you have to be concerned about the primary engagement standard under the Investment Company Act because security futures are deemed to be securities under the '40 Act.

If you are a registered investment company, you can also add security futures to the mix of portfolio products that you make use of, but you can do so only in compliance with CFTC rule 4.5, which gives an exclusion from commodity pool regulation, subject to certain trading limitations.

And these have proven in the past, I think, to be reasonably workable, although I'll make some suggestions maybe later in the discussion

about how we might make them more flexible.

Registered investment companies can use futures for hedging purposes, and they can make use of futures for speculative purposes up to a 5 percent cap on the margin deposits that they post for those positions.

Now in the case of security futures products, this 5 percent cap does have the potential to be a significant restraint because of the relatively high regulatory margins for security futures products.

Now turning to hedge fund managers who are not currently using futures and therefore not registered as commodity pool operators, the basic definition of a commodity pool operator which has been adopted historically by the CFTC, which is that if you add even one futures contract to your mix of portfolio investments, you become a commodity pool, adding a security futures product would have that -- would clearly have that effect.

And not only would he have to register, but unless your fund happened to qualify for CFTC rule 4.7 exemption, you would have to create a new CFTC part 4 compliant commodity pool disclosure document.

Now I know David Harris is going to discuss the commodity pool issue at greater length, and I think, therefore, I will defer to him on those issues, but I do want to make one final point, which is that I think that one of the aims of the Commodity Futures Modernization Act security futures provisions was to reduce the likelihood of regulatory arbitrage to avoid determining the success or failure of this product, based on regulatory requirements. In many contexts, the CFMA maintains parity between security futures and security options precisely for that reason, no doubt.

And in considering competing products, hedge fund managers who are not currently operating 4.7 exempt funds will most certainly have to give serious consideration to security futures products' regulatory consequences in making a decision about whether to use those products.

So I think this is one area where really looking to how the market user will consider the regulatory consequences of the product may give us pause because it may result in diminished use of a new product which I think that many at this table hope will be a great success.

Thank you.

MS. THORPE: Thank you, Susan.

David, can we go right to you?

MR. HARRIS: Yes. Thank you very much.

I should probably take a second to introduce myself because I am a new face, especially in the futures world.

I am the general counsel, NASDAQ LIFFE Markets. I come actually from the NASDAQ side of the family. You can probably tell I don't have the British accent.

What we have been spending a lot of time doing over the last year or so is going out and educating potential users of single stock futures, and certainly a target group that we have been educating is managed funds.

What we have discovered is that the vast majority of the funds immediately recognize the importance and the benefits of this product.

There are other funds that take a little time to educate. You know, they think that there are -- and in fact, there are -- other investment vehicles out there that replicate a single stock future, and until we take them through the process as to why these products are more efficient than

the other alternatives, they are not inclined to use single stock futures.

Once the light bulb goes off in their heads and they see the benefit of single stock futures, invariably you get to the issue of single stock futures, well, do I have to register as a CPO? And the answer obviously to that question is yes. And just as quickly as the light bulbs go on, the light bulbs go off.

And in like everything, you know, when you say cost-benefit analysis for these firms, and they look at the costs associated with becoming a registered CPO, and most of the funds that we are focusing on -- I should step back.

A lot of the funds that we are discussing don't have this issue. They are already registered entities with the CFTC. A very large group, though, are not registered with the CFTC, and but for single stock futures, have no intent to register because they don't intend to trade futures products.

We walk them through the analysis, and what it is to become a CPO, and at the end of the day, given the registration requirements and the disclosure requirements, they would prefer to

remain an unregistered entity. A lot of these funds are very small funds, and it requires additional cost of hiring attorneys, bulking up with staff, et cetera.

We have even tried work-arounds where maybe a fund has several different types of funds and they are able to offer the single stock futures product to those funds where they could potentially have QEPS.

We even get pushed back in that space because some of the funds have investment philosophies that they apply across funds, and they are not willing to change the way they invest and the way they trade.

We are obviously incredibly focused on this issue because as Chris and Bob will tell you, and as everybody knows, when you're trying to start a new market, a new product, liquidity is king. And this group is a very, very important liquidity pool, and we feel it's important to tap into.

We are obviously very aware of the other proposals that are out there and, in fact, we support them very much.

And having worked with the Commission over the last year, you know, we went through the

contract market designation process, and we have found them to be and are grateful for the thoughtful approach that they have taken and the ability to focus and have smart solutions to very innovative problems. And this clearly, for me, is an innovative problem, because the funds that we are going to have the ability to trade products that are not futures, and obviously the one that pops up for the option combinations replicate futures, and given all the effort that we have gone through in getting the margin rules out and the other rules out and ensuring that there is not regulatory arbitrage, that there are not undue competitive benefits from one equity product that goes across to the futures product, this is one that we feel does shut out a group of potential players.

I understand, and we are very mindful of, the environment that we are in. It is very hard to say, look, you know, less regulation is better. And from where I sit, you know, these are people that are already not regulated, and we recognize obviously the changes in the wind for these firms. They recognize the changes in the wind. But as an incremental step, we could allow an exemption for

people who trade in single stock futures to either dovetail into some of the existing proposals to have some limits or caps on it, and through us, or designated contract markets, through OneChicago or through Island, you're going to get a window into people that you otherwise wouldn't have a window into.

And actually I'll kick it to Chris or Bob.

MR. PAUL: Never let it be said I didn't take the ball.

Again, I'm Bob Paul, general counsel of OneChicago, and I guess I'd better do a brief disclaimer. I certainly don't pretend to speak on behalf of OneChicago as an entity, but more importantly, of our three partners, the Chicago Board of Trade, the Chicago Mercantile Exchange, the Chicago Board Options Exchange, who have formed this joint venture for this product, but they have their own interests which sometimes -- which often coincide with ours, but not always.

The easy thing for me to say is ditto to everything that Susan and David said. I agree with all of their proposals.

I also want to follow Jack's lead and do a mea culpa. I don't know how we slipped up on this

when we were working on the CFMA when I was at the CFTC, but I do want to share some of the blame with my fellow panelist, Susan Ervin, since she probably figured I would do this.

In forging all of the compromises and the new approach to joint regulation with the SEC, the CFTC and SEC staffs had to often recruit help from outside the agencies, and when we were tackling the '40 Act issues and CPO-CTA issues, Kate McGuire and Annette Nazareth suggested Susan Ervin and I, I went along with that, to bring her in to help mediate with us, and Bob Plaze from Paul's group.

And I think at that point we were probably -- and I guess since Susan was an alum of the CFTC and I was still there -- we were more focused on trying to address the SEC's jurisdictional incursion into futures and were not as focused or as concerned about the enlightened folks at the CFTC bringing in redundant or duplicative regulation from the futures side into the securities side.

I think this is one of the rare instances where we do have this anomaly where the CFTC regulations would create additional regulatory

costs and may in fact discourage some new entrants into the security futures markets by virtue of the CPO rules, you know.

And as Susan explained, we have an exemption built into the statute for CTAs and investment advisers, though it could be clarified and still subject to interpretation. But the fact that there is no similar reciprocity for hedge funds managers who might want to trade single stock futures or narrow indices to hedge their portfolios of securities, it's a gaping hole, and one that I think can be addressed and filled fairly effectively by the CFTC taking action unilaterally through either exemptive relief or new action relief, and then if the industry deems that more might be necessary, we can discuss whether or not, you know, an additional legislative fix is necessary.

But I think the way that CFMA is structured, I think the beauty of it is we can probably get most of the way there through CFTC action, and I think that's what we're all here today to request.

I think that a couple of things do bear repeating, and as David pointed out, you know, we

have an embryonic product here that may or may not succeed. A few people at this panel have mortgaged their futures on that success, but, you know, the whole idea when we were working on the CFMA was we'll let the markets decide whether or not there is a demand for single stock futures and narrow-based indices, but that should not be determined by the legislators or regulators, and that was what went into lifting Shad-Johnson accord and the ban on security futures.

I think as David correctly points out, this could be an instance of regulatory arbitrage, and you could end up with the anomalous and the -- you know, deleterious effect of fund managers who will pursue hedging strategies limited to options which could be more expensive and we don't think might be as cost-effective as security futures.

And even more importantly, and this is another point that I thought David made effectively, you know, you might be chasing some of the business offshore. And this was something that I know was very important to the Commission in crafting the CFMA, both in its overhaul of futures regulation as well as some of the other areas that we were addressing with the over-the-counter

markets, and that was the reason for the creation of the eligible commercial entity category, the thought being that better to bring this business to the U.S. and bring it under some regulation with the U.S. regulators, both the SEC and the CFTC, and give the investors in those pools some protection of those bodies, than to create a framework that would deter anyone from bringing it here and figure out how to offer the same product offshore.

I think that that would hurt both the U.S. investors who might want to invest interest, it would hurt the U.S. investors who are already invested in some of these funds who will be deprived of the ability to hedge with all the products that might otherwise be available, and it could also have a detrimental effect on the development of single stock futures in this country as opposed to the way they're developing and can develop in other jurisdictions.

So for all these reasons, I think that it's clear that we need some help from the CFTC, and I think that Susan and David have laid out an effective blueprint on how we can start, and, you know, we certainly will do everything we can to help assist in completing the most effective

resolution to the problem.

Thank you.

CHAIRMAN NEWSOME: David, let me get this clear. Is Bob admitting that he made a mess and he's expecting us now to clean up that mess?

[Laughter.]

MR. HARRIS: No.

[Laughter.]

CHAIRMAN NEWSOME: He tried to drag you into it, Susan, but --

MR. HARRIS: Mr. Chairman, I don't think we have enough time to try to respond to that comment.

MS. THORPE: Chris, would you like to make a statement?

MR. CONCANNON: I have to admit when I first heard about this issue, I had to pull out my CFMA because I couldn't believe that Bob Paul actually screwed it up.

[Laughter.]

MR. CONCANNON: But we've had --

MR. PAUL: Somehow I don't think I like the direction that this roundtable is taking.

[Laughter.]

MR. CONCANNON: We've had a very similar

experience to David's experience. Island is very highly distributed on the equity side. The hedge fund community is very active in our equities business, and they are a customer that we looked at, and we surveyed before we decided to go into this venture in security futures. And just the limited survey that I have taken, and our staff has taken, among these hedge funds participants, they just will not trade security futures if they are faced with a regulatory regime that they, you know, they have been structuring all their products and limiting their distribution to stay within this very narrow regulatory structure on the equity side.

So for them to trade a product that triggers any type of registration requirements, it would be a very hard decision for them.

On the point that David has made about the success of the product without these participants, I think that's critical. You can't have an efficient market unless you have a variety of different participants, and the hedge fund community being left out will leave this product -- it will start and will trade, but it will be an

inefficient market, and that in the end will end up hurting other investors when you don't have full participation of all the investment classes out there.

So I support David and Susan's proposals. I think they are reasonable given the current regulatory/political environment, when it's very difficult for a regulator to, you know, eliminate certain regulations. I think you have to be careful, and I think the community understands that the regulator is in today, and I think those proposals are fairly reasonable, given that environment.

MS. THORPE: Thank you very much.

I think security futures more than anything else highlights the unintended consequence of the very broad definition of the term commodity pool operator in the Commodity Exchange Act, and the Commission staff has had before it two proposals, one from the Managed Funds Association and one from the National Futures Association, that could help address these problems.

I would like Jack to start off with a discussion of 4.9, and perhaps Dan can talk about the de minimis approach. Thank you.

MR. GAINE: All right, thank you.

Speaking of the CPO definition, this would be the third mistake that I made while I was here, which isn't bad, three mistakes in over four years.

I used to argue with my deputy, Dick Nathan, on the definition that if Pillsbury, which then was an independent company, had a public stock offering and some of the proceeds were going to be used in the futures markets, did that make it a commodity pool. He said he would have to get back to me on it.

Well, that's absurd, all right, that they would be a commodity pool, but you had to know Dick. I think he was kidding.

[Laughter.]

MR. GAINE: This -- and I am here talking about our proposal, 4.9, which is actually we provided a solution for single stock futures people before you even had the problem, and what we had proposed to the Commission and have been discussing with staff for some months now, is an exemption from CPO registration for CPOs of pools that are sold only to sophisticated persons in private transactions exempt from registration under the Securities Act.

A person would be exempt from registration as a CPO, but remain subject to the jurisdiction of the Commission, which is very important for a number of reasons. The Privacy Act, perhaps, the Anti-Money Laundering, et cetera.

Interest in the pool would all have to be exempt from registration under regulation D. All individual investors would have to be qualified eligible persons as defined in CFTC rule 4.7, and all entity investors would have to be accredited investors under I think it's reg D, or qualified eligible persons, as defined in 4.7.

And then there are other provisions in our rule that the operator and its principal had to have a clean history, et cetera, et cetera, and have to represent that.

The CPO would remain subject to anti-fraud and anti-manipulation provisions of the act, audited year-end financials would have to be provided, a notice of eligibility would have to be filed with the Commission, the CPO would be subject to special calls.

And there are a number of other technical things that we hammered out with the staff, but essentially what we did, we took the philosophy

behind the CFMA. The philosophy was sound. It was just when Bob was implementing pieces of it that it fell into problems, but the philosophy was this: That the degree or presence of regulation should somehow be geared to the sophistication of the investment, whether eligible contract participant or whatever one of Emily's terms you want to use.

But we looked at what was done in the CFMA. We looked at what 3(c)(7) and reg D did, and we said, to get around this, you know, you can't be a little bit pregnant, you know. One contract puts you into this morass of regulation.

What benefit does registration bring to a sophisticated investor base? And we have come up with this proposal. We have hammered it around. I will -- there are a number of people who are interested in this, and I won't go on further, but its policy basis is similar to the CFMA, and 3(c)(7) and reg D. This is not retail. You can't go to Charles Schwab and buy into this thing.

The Commission, for its part, this Commission, retains its overall jurisdiction and particularly the anti-fraud manipulation jurisdiction, and we think it makes sense.

Granted, the environments come and go, but

doing the right thing is always kind of a nice concept. We think this is the right thing to do, and we strongly urge this Commission to seriously consider it.

MS. THORPE: Thank you very much, Jack.

Jack Rigney.

MR. RIGNEY: Thank you.

We heartily endorse the 4.9 proposal, and I have to go back to the prior discussion. I completely endorse Susan's proposal on single stock futures and I think David very ably described the kind of issue we have been seeing for years, all revolving around this one issue, one instrument that's deemed to be under the commodity jurisdiction, makes the entity a pool. And whether it's a rational reaction or not, we -- I don't need to comment on that, but there's no question, hedge fund managers hear us tell them this is what you have to do to be able to trade these instruments.

And my own personal view, by the way, is this has gotten a lot easier with the NFA review of disclosure documents, the possibility of getting a series 3 exemption. It may not be so bad. But in any event, it's clearly an industry reality that managers, when they hear that's another form of

registration, that it takes more time, for whatever reason, they just are not interested.

There is no doubt in my mind that this is going to happen if the single stock futures proposal is not refined as has been suggested.

So this 4.9 proposal will go a long way. This is something we have been talking about, not this exact proposal, but this kind of relief, for years, and what it will do, of course, it's going to benefit the consumer, benefit the investor, because I can't tell you how many times we've had calls from clients, who should know these rules, but they don't. They will call if they want to buy a particular derivative and will say can I do it,a neighborhood then we have to get into these descriptions of whether it's a commodity or a security. All they want is a yes-or-no answer. They get frustrated when we tell them that it's a commodity. They can't keep it straight. They'll call a month later with the same question, but it does -- all that does is, of course, because the manager is not willing to go through the registration, perhaps for different reasons, it hurts the investor in the fund. If these instruments are an efficient way to benefit the

investor, this policy of the one commodity contract requiring registration certainly has hurt the investor, in my mind. That has been our perception, and I think everybody who has spoken before me on this has captured that, and I think this is probably the biggest issue that we have had since we have been practicing in this area.

Thank you.

MS. THORPE: Thank you very much, Jack.

Dan.

MR. DRISCOLL: Actually for the last several years NFA has been proposing to the CFTC to adopt a so-called de minimis exemption from CPO registration, which is really designed to deal with the same problem that proposed rule 4.9 would, where you don't get in this dilemma where one futures contract or several futures contracts for a firm that's primarily engaged in another business would have to register as a CPO.

The whole idea of de minimis would be that you would have some sort of measurement much like rule 4.5 that says if the small percentage of your assets are devoted to futures margin, and it's incidental to your normal business, then you wouldn't have to register as a CPO. And there's no

magical number. I think we would have to sit down and figure out what that number is. But it would be one way to deal with this issue.

I do want to point out that when you really think about the hedge funds and other types of entities that we are trying to deal with here, that really most of those would fit under either 4.9 or the de minimis. They are unlikely to have most of their business being in futures, and they are unlikely to be dealing with retail customers.

So there is no pride of authorship at NFA here. It's not like we're debating with MFA that it's either 4.9 or de minimis. But we strongly believe there needs to be something there to deal with this issue.

MS. THORPE: Thank you very much.

What I'm hearing from all of the speakers on this issue is that it's the fact of registration and not the process of registration that is the impediment. Because, as many of you know, the staff has been working on a proposal that might deal with some of the issues related to the process of registration, but fundamentally the problem is once they're in, they're regulated, and that seems to be problem.

One of the issues that I wanted to ask David is that, you know, we have been talking about the MFA standard, which is based on accredited investors under 4.7. In terms of the kinds of participants and the kinds of hedge funds that you're out there trying to solicit interest in these products, is that an appropriate standard? Are there other standards? Is it too low, is it too high?

MR. HARRIS: Well, sometimes, frankly, we don't even get that far down the road. We sponsored with Bloomberg on Tuesday an educational seminar devoted to managed funds, to hedge funds, and we don't walk down the path very long when they learn that there is a registration requirement. They completely shut us out, and we don't have an opportunity to continue to walk through what the right standard would be.

I get the sense that a standard such as accredited investor standard would be probably be most appropriate or more appropriate, but Susan is -- do you have a --

MS. ERVIN: I think that's a good point. Apparently a number of the funds that NQLX and other security futures exchanges have been talking

to have made the point that they are not -- they would not qualify under 4.7, so they would have to kick people out of their funds or otherwise seek relief to be able to deal with currently offered or previously offered funds that have non-QEP investors.

So I think Dan's point is a good one, that probably most of the issues are addressed either by the MFA or the NFA proposal, but probably not by either one in itself.

MS. THORPE: Yes, Emily.

MS. ZEIGLER: I guess I'd like to plead guilty to being involved in and supporting both of these proposals, and I just want to say the same thing that Susan just said, which is I think you probably do need them both, and together they will cover kind of the vast array of folks who don't need to be registered one way or another, either because they only do a tiny little bit of futures, or because they are dealing with sophisticated people.

MR. CRAPPLE: There have been many decades of scholarship on the question of what is an investment company. I remember when we first were launching futures pools, and I almost hate to admit

this, it was back about 1973 and I probably have more grandchildren than Marianne, but the investment company people at the SEC took the position a way back then that, hey, yeah, commodity pools, their underlying assets are in securities, and they always have been, but their principal purpose is clearly trading futures. And so they are not investment companies.

Now I don't see what is wrong with that kind of concept, where you have all sorts of investment pools whose principal purpose is clearly trading securities of one sort or another who want to trade some derivatives, some futures. Why can't -- I mean going beyond what these proposed rules say, why can't we have a principal purpose type of definition of what is a commodity pool.

MS. THORPE: Any other comments?

Terri.

MS. BECKS: I guess I need to speak from the other side of the fence. You're dealing with all the issues for firms that are trading in equities on the futures side, and going back to a public futures fund, Susan did mention this in her comments in the beginning, as a representative of a public futures fund, we are unable to invest in

security futures products for our fund because we would have to -- that would be deemed to be holding ourselves out as an investment adviser, is my understanding, and so we would have to be registered as an investment adviser.

So we would -- as you all are pleading to the CFTC, we would also like to put in our plea to the SEC about a notice IA registration allowance for CPOs, and further request that the notice IA be exempt from the qualified client requirements because it is a public pool which is below the qualified client.

But again, as long as it's a de minimis investment in security futures and as long as we're primarily a futures-dominated pool, that we think we would like to make that request.

MR. GAINE: That's a question -- Paul, I won't put you on the spot today, but there is some confusion within the futures industry. The CFMA carve-out -- and I have not looked at it in six months or so, but from the Investment Advisers Act, I think reads something like if you are a registered commodity trading advisor whose business is not principally engaged in advising as to the value of securities, you are exempt from

registration as an investment adviser.

I don't see where holding yourself out is relevant to that, if indeed -- and that's a different, you know, 15 or fewer, don't hold yourself out, that's category A.

Category B is if you're a registered CTA whose business is not primarily engaged in advising as to securities. So if you have a futures fund which has soybeans and sorghum and silver and gold and whatever else it has, and 6 percent of single stock futures, it doesn't seem to me that that would trigger investment -- I'm not -- I'd like to say that we want to come to you and get an answer to this question, because you don't have the statute in front of you or anything, but there is some confusion.

My reading of it is that, that there is some -- that level that brings you below primarily engaged in the advising as the value of securities or the advisability of investing in securities will permit a registered CTA to advise a public futures fund, even if it is holding itself out to the public.

MR. ROYE: Yeah, this is an issue that, you know, we should think about, and I would just

point out that this is on our agenda, if you look at the Commission's reg flex agenda that we published, I guess the most recent one I think in May. But we have this listed, the issue of commodity pool operator exemption under the Advisers Act.

We recognize that Bob made a mistake there, and --

[Laughter.]

MR. ROYE: -- perhaps we ought to focus on that one and deal with it.

But, yeah, it's something to think about, and I think, you know, we -- quite frankly, though, we haven't had, to my knowledge, a lot of questions on this issue of what's, you know, what does primarily engaged mean. And I don't know if that means that people are afraid to ask us the question for fear of the answer, but we'd be glad to talk to you about that.

MR. GAINE: Well, I think it's probably, you know, some urgency at least in the single stock futures area. I know we had a conversation some months ago and Bob Plaze was going to be involved in it, and there is some clarification, but maybe potentially some interim relief of a no-action

position or something like that. But it's something that the affected parties should get their act together and come back and see you.

MS. THORPE: Thank you very much.

MR. GAINE: Did you sign off on 4.9 while --

[Laughter.]

MS. THORPE: Bob, not only is it unanimous, it's on the record.

Okay. Well, we actually had reserved 30 minutes to discuss a range of other issues that have been issues of long-standing interest to the managed funds industry, and we are actually over time at this point.

I don't know, Jack, if you would like to take just two minutes to at least identify what these issues are, and we could certainly listen to further submissions.

MR. GAINE: Well, what I'd like to ask is maybe -- this would my nature, Marianne. Art Bell and others who are here, who might have just issues to throw on the table. I think we have covered, either in our written testimony or we also intend to supplement the record, we will cover any other issues. But I think if you just leave it open to anybody else.

MR. BELL: Well, Jack, thanks for yielding your time. I'll try to keep it to two minutes, and I want to thank Chairman Newsome for calling the meeting, the CFTC Commissioners for attending, and the members of the CFTC and SEC staffs for participating in this, and Jane for trying to moderate and keep it right on schedule. That's no small task.

MS. THORPE: I failed.

MR. BELL: Well, because of me running long.

I will also dispense with the disclaimer because if I don't speak for my firm, I don't know who the hell does.

You know, hearing remarks around the table of harmonizing the relationship, of cooperation, of setting all the clocks in the same time zone, reminds me of the expression that everybody wants to go to heaven, but nobody wants to die. And I would challenge Chairman Newsome and the people I mentioned at the CFTC staff and the SEC staff that if we really want to accomplish something today, somebody is going to have to take responsibility, somebody is going to have to take some unpopular stands. The status quo won't do it. Things have

to be changed.

I think it's more likely that I'll get pregnant than that the Corp Fin is ever going to be able to review public financial futures funds with any success. It just doesn't fit there. It's a round peg in a square hole.

You know, if we want to get something done, people have to change their attitudes.

Now there is precedent for this in the single stock futures. I think it's incredible the way that the CFTC and the SEC has cooperated with a clean sheet of paper to come out and work and determine which agency can best handle which things, and to the extent that you have some regulatory requirement with another one, that you can notice file with them, and true, there may be some unresolved issues at this point, but it is an example of where things can work.

Another example was ceding the review of the disclosure documents to the NFA. The CFTC looked at this and said who really is in the best position to do this efficiently. That's been done, and the history on that has been very encouraging, it has been very positive.

So things can be done, but people are

going to have to take some aggressive stands on this.

Dave -- Steve Olgin, rather, volunteered to be on a task force to work with it. That's the kind of thing that we need. I'll certainly volunteer on that, mostly because associating with lawyers is moving up the social ladder as a CPA, probably, but nonetheless, there are things that can be done here, but we are going to have to really commit to do it.

Barbara Holum is not here, so I can talk nice about her, but Barbara has the GMAC committee, and the way that things were accomplished there was by actually assigning a task force between the industry and the government to work on these things.

So if we want to do better than just muddle through, which is really what's happened on a lot of these issues, we have got better than 20 years of experience since the CFTC has been in operation, and I think it's time to look back and as we've done with the single stock futures say what's really the best way to deal with these issues. And if people are prepared to do that, then we can do a whole lot better for the American

public and the people in this room than just continue to muddle through.

Thank you.

MS. THORPE: Thank you.

Chairman Newsome.

CHAIRMAN NEWSOME: Thank you.

I guess as we wrap up, I have just got a couple of comments that I would like to make, Jane.

First and foremost, I'd like to thank each and every one of you for taking the time to be here today, to share your comments with us. I would especially like to thank our friends from the SEC for being here and sharing your thoughts and viewpoints. I think they have been extremely valuable.

With regard to Art's comments -- and I would say that I agree totally, and I think that Chairman Pitt and I have not only shown a willingness but have shown the ability to operate outside the traditional parameters of the two agencies, and we will continue to do so.

Certainly some issues have been laid on the table today that I think the CFTC can and should address in a quick manner, and there are other longer term issues that I think the agencies

jointly need to address, and certainly I am of the view that I would be glad to meet with Chairman Pitt, and he and I hopefully agree on a method of moving forward, possibly with a task force of industry participants and the agencies represented.

So, again, thank you for a very productive dialogue today.

MS. THORPE: Thank you very much. Thank you all very much for coming.

[Whereupon, at 12:47 p.m., the meeting was concluded.]