1660 Lincoln Street
Suite 100
Denver, Colorado 80264
303.837.0600
Fax: 303.832.9354

October 18, 2010

Via Email to: NFAamendrule4.5@cftc.gov
Via Fax to: (202) 418-5521

David A. Stawick
Secretary
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: National Futures Association Petition to Amend Commission Rule 4.5

Dear Mr. Stawick:

Equinox Fund Management, LLC ("Equinox") appreciates the opportunity to submit this comment letter in response to the notice and request for comment from the Commodity Futures Trading Commission ("CFTC") following a petition for proposed rulemaking ("Petition")[1] submitted by the National Futures Association ("NFA") to amend CFTC Rule 4.5 ("Rule 4.5"). Equinox acts as registered investment adviser to MutualHedge Frontier Legends Fund ("MutualHedge"), one of the registered investment companies referenced in the Petition. Equinox is also a commodity pool operator ("CPO") registered with the CFTC and the NFA and is the sponsor of The Frontier Fund, a public commodity pool. As such, we feel that we are uniquely situated to offer our thoughts and insights on the Petition's proposal.

In the Petition, the NFA requests that the CFTC amend Rule 4.5(c) to restore operating restrictions relating to certain registered investment companies, and specifically commodity mutual funds, that are substantially similar to those in effect prior to 2003. The NFA cites specific concerns in the Petition. First, the NFA notes that, to the extent that the amendments to Rule 4.5 in 2003 were in part premised on the "otherwise regulated nature" of certain investment companies, this premise may no longer be valid. The NFA further asserts that, without these operating restrictions, commodity mutual funds are marketed and sold to customers, including retail investors, who may be unsophisticated in commodity futures investments. The NFA argues that the offering materials of these commodity mutual funds omit substantial disclosures that would otherwise be mandated by the CFTC's Part 4 regulations. Finally, the

[1] Letter from Thomas W. Sexton, III, Senior Vice President and General Counsel, NFA, to David Stawick, Office of the Secretariat, Commodity Futures Trading Commission (August 18, 2010), available at http://www.nfa.futures.org/news/newsPetition.asp?ArticleID=3630. The NFA withdrew its original June 29, 2010 Petition for Rulemaking to Amend CFTC Regulation 4.5 by separate letter dated August 18, 2010 and resubmitted its petition on August 18, 2010.

NFA highlights its customer protection concerns relating to commodity mutual funds' use of wholly-owned and controlled subsidiaries to invest in commodity futures investments.

Response and Position

We believe that the existing regulatory framework of the mutual fund industry has provided unparalleled protection for retail investors both during the recent financial turmoil and scandals, and throughout the past several decades. In fact, our experience suggests that many financial advisors have shied away from managed futures investments for their clients, via commodity pools, for two main reasons. First, there is real concern over the lack of a robust set of alternative investment products in a 1940 Act-registered solution, including with such features as mandated daily liquidity. Second, many financial advisors struggle to rationalize the higher fees and possible conflicts of interest often associated with private and public commodity pools.

Contrary to the suggestion that commodity mutual funds were registered as investment companies under the Investment Company Act of 1940, as amended (and, together with the rules and regulations promulgated thereunder, "1940 Act"), to take advantage of a perceived regulatory gap created by current Rule 4.5[2], MutualHedge and scores of other commodity mutual funds were, in fact, registered as investment companies to accomplish a wide variety of important investor-centric and business goals. These include a response to investor demand for a host of 1940 Act protections, a better liquidity profile and the ability to invest in exchange-traded funds and fixed income securities as part of an overall investment strategy.[3]

For the reasons outlined above and expanded on below, and based on the experience of the past several years in which the SEC and CFTC have regulated commodity mutual funds and commodity pools, respectively, we respectfully submit that Rule 4.5, in its current form, should remain in place. In taking this position, we fully appreciate the proactive stance and recognize the laudable goal of the CFTC and the NFA to regulate commodity futures products to protect investors.

Current Regulatory Regime Governing Mutual Funds

The current regulatory regime governing registered investment companies and registered investment advisers has been primarily within the jurisdiction of the Securities and Exchange Commission ("SEC"), administered pursuant to the 1940 Act, and the Investment Advisers Act of 1940, as amended, and the rules and regulations promulgated thereunder ("Advisers Act"). It is under this regime that a number of commodity mutual funds have been formed and operated without any prior objection from the CFTC or the NFA.[4]

---

2 *See, e.g.,* Statement of Commissioner Scott O'Malia on September 1, 2010 on Changes to Improve CFTC Oversight of Retail Commodity Funds, available at http://www.nfa.futures.org/news/documents/Commissioner_OMalia_Statement_090110.pdf.

3 As disclosed in its Form N-Q as of June 30, 2010, MutualHedge holds a large percentage of its assets in exchange-traded funds that invest in a broad cross-section of fixed income securities.

4 *See, e.g.*, Oppenheimer Commodity Strategy Total Return Fund, PIMCO CommodityRealReturn Strategy Fund, Credit Suisse Commodity Return Strategy Fund, DWS Enhanced Commodity Strategy Fund and Rydex Managed Futures Strategy Fund.

The current regulatory regime has made mutual funds an attractive investment vehicle for the past seven decades. More specifically, mutual fund shareholders enjoy extensive protections under the 1940 Act, including, among others, enhanced liquidity, requirements related to independent boards and custody of assets, coverage requirements relating to certain investments, restrictions on investments, restrictions on transactions with affiliates, limitations on advertising and sales materials and enhanced disclosure obligations. Since 2003, when the proposed restrictions were removed from Rule 4.5, the provisions and interpretations of the 1940 Act and the Advisers Act have been further enhanced and refined to better protect investors.

The Petition refers to three mutual funds that filed exemptions from Rule 4.5 since 2003 and invest in the commodity futures and options markets that, among other things, give rise to the NFA's concerns regarding the current coverage of Rule 4.5. While these entities may differ in some respects from previously-filed mutual funds, we are not aware of the rationale for the newfound concerns expressed by the NFA. Scores of mutual funds offering material exposure to commodities futures investments have been formed over the past decade. The largest such fund was formed prior to 2003.[5] The investment strategies of these dozens of commodity futures funds include long-only, long/short, actively-managed, passive index and various combinations of such strategies, but the NFA did not express any concern regarding the lack of appropriate investor protections being afforded by these funds, including those funds formed prior to 2003. Moreover, there is no evidence that the NFA cited, or that we have knowledge of, where investors in these entities have suffered harm as a result of their investments in these funds.

Certain CPOs and commodity trading advisors ("CTAs") have argued in favor of the amendments proposed in the Petition on the basis that current Rule 4.5 results in an unfair competitive landscape and grants a competitive advantage to mutual funds. The actions of these CPOs and CTAs, however, appear certainly to be driven more by an effort to protect their current business models and related fee structures than by any sudden interest in investor protection. We believe that competitive advantages should play a secondary role in regulatory oversight and that the primary consideration for CFTC and SEC regulatory oversight should be the best interests of investors.

We believe that the current regulatory regime governs mutual funds and investment advisers appropriately and adequately and effectively serves the purpose of best protecting the interests of investors. Furthermore, we believe that the proposed amendments to Rule 4.5 would adversely affect mutual funds through the addition of conflicting and/or duplicative rules that would not further the goal of investor protection.

Disclosure Requirements

The Petition notes that offering materials of commodity mutual funds omit substantial disclosure that would otherwise be mandated by the CFTC's Part 4 regulations. The Petition further argues that, absent the proposed amendments, commodity mutual funds are marketed and sold to customers, including retail investors, who may be unsophisticated in commodity futures investments.[6] It is important to note that mutual funds are currently subject to extensive disclosure requirements under the 1940 Act. These

---

5 *See, e.g.*, Oppenheimer Commodity Strategy Total Return Fund (Inception: 3/31/97) and PIMCO CommodityRealReturn Strategy Fund (Inception: 06/28/02).

6 Aside from mutual funds, we note that there are robust markets in structured notes and linked certificates of deposit offering investors exposure to commodities futures markets.

include, among others, disclosures related to a mutual fund's objectives, strategies, risks, fees and performance. Moreover, such disclosures are required to be written in plain English, understandable for the average unsophisticated investor.

In addition, recent amendments to the mutual fund registration statement Form N-1A added additional summary disclosure to further enhance the review of a mutual fund's registration statement by average investors. In our experience, investors – particularly retail investors – demand clear and concise disclosure documents. Yet, the inclusion of an additional set of CFTC-required disclosures, many of which are not materially different from those required by the SEC, could unnecessarily burden and potentially confuse retail investors. In addition, the cost of gathering and providing such additional disclosures is likely to be passed on directly to customers in the form of higher expenses.

Mutual funds are also required to provide disclosure on the brokers used to execute portfolio transactions, similar to commodity pool disclosures of their futures commission merchants. Annually, and in the event of any material changes, mutual funds are also required to update their offering document disclosures to include updated and current financial information.

The Petition also cites customer protection concerns relating to the use of wholly-owned subsidiaries to invest in commodity futures transactions. While such subsidiaries are generally not registered as investment companies under the 1940 Act, the revenue rulings issued by the Internal Revenue Service, as well as various SEC no-action letters and other SEC guidance, require that certain investor protections be implemented in order to utilize the subsidiary structure.[7]

Mutual Fund Coverage Requirements and Investment Requirements

The 1940 Act includes provisions that require mutual funds to "cover" certain transactions that expose its shareholders to a risk of loss thorough a leveraged investment, including investments in commodity futures and options trading. A registered investment company may "cover" its risk of engaging in such transactions by segregating or earmarking liquid securities equal to the value of its potential exposure from engaging in the transaction.

The 1940 Act also imposes strict restrictions on the liquidity, concentration and diversification of investments, and requires that mutual funds adopt certain investment restrictions on borrowing and encumbrance of fund assets, among other things, in order to enhance investor protections.

Anti-Fraud Provisions

A concern that has been raised is that commodity mutual funds that are unregulated by the CFTC and the NFA are at greater risk for fraud. However, under Rule 206(4)-8 of the Advisers Act[8], investment advisers to mutual funds are prohibited from engaging in certain fraudulent conduct. This rule enables the SEC to bring enforcement actions against investment advisers for false or materially misleading

[7] We further note that the bill, "H.R. 4337 Regulated Investment Company Modernization Act of 2010" recently passed by The House of Representatives, may obviate the need for the use of controlled foreign subsidiaries, in which case there would be no further basis for the concern expressed by the NFA in the Petition regarding the use of controlled subsidiaries.

[8] We also note that there are parallel anti-fraud rules under the 1940 Act, the Securities Act of 1933, as amended ("1933 Act"), and the Securities Exchange Act of 1934, as amended.

statements, or omitting to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading. Furthermore, investment advisers are prohibited under the rule from engaging in any act, practice or course of business that is fraudulent, deceptive or manipulative with respect to any investor in a mutual fund. Again, this rule (and parallel rules under the other Federal and State securities statutes) is analogous to the anti-fraud provisions that apply to commodity pools under CFTC and NFA regulation. Moreover, the rule has applied to commodity mutual funds existing prior to the Petition.

Discussion of Benefits of Commodity Mutual Funds vs. Commodity Pools

Certain benefits of investing in commodity mutual funds, including a discussion of the protections provided to investors in each structure, are described below. It has been our experience that investors demand and expect these protections when seeking managed futures investments. Whereas previously, retail investors have had limited interest in investing in commodity pools, investors' demand for mutual funds with exposure to the commodity futures and options markets has been very strong. The popularity of commodity mutual funds is driven in part by the regulatory differences described below.

Independent Boards of Directors and Custody of Assets

Mutual funds are required to have a board of directors, at least 40% of which must be independent. Moreover, if a mutual fund relies on certain exemptive rules or orders, as most do, a majority of the board must be independent. The 1940 Act requires that a majority of a mutual fund's independent directors vote separately on certain fundamental matters. Board oversight under the 1940 Act also helps address conflicts of interest (such as the negotiation of a mutual fund's fee structure) that may arise between the objectives of fund insiders, such as the investment adviser, and the interests of the fund and its shareholders. The basis of a board's approval of an investment adviser's advisory contract must be included in a mutual fund's shareholder reports. Furthermore, recent amendments to Form N-1A require a mutual fund's statement of additional information to include information on each director's experience, qualifications, attributes and skills that led to a determination that the director should serve on the board.

Mutual funds must also meet certain requirements with respect to the custody of their assets and the oversight of their administrators in order to adequately preserve and protect mutual funds' assets.

Such requirements for an independent board, custody of assets and oversight of administrators go beyond the requirements for commodity pools under existing CFTC and NFA rules.[9] It is also important to note that public and private commodity pools, which generally do not have independent boards, typically charge materially higher fees than mutual funds. Moreover, our experience has been that the requirements for mutual funds to have a majority independent board is a critical protection demanded by potential mutual fund investors.

Limits on Affiliated Transactions

In order to prevent self-dealing and enhance investor protection, Section 17 of the 1940 Act prohibits certain transactions with affiliates, the definition of which under the 1940 Act is far-reaching in scope.

[9] We recognize, however, that segregation of customer funds held with futures commissions merchants has long been an important protection available to customers in the commodity futures and options markets.

These mutual fund restrictions go beyond existing CFTC rules governing transactions between a CPO, CTA, and their affiliates. Under current CFTC rules, transactions with affiliates are permitted, provided that general disclosure of such transactions is included in the commodity pool's offering documents.

Limitations on Performance-Based Compensation

Section 205(3) of the Advisers Act prohibits an investment adviser from charging a fund a performance-based fee unless it is a "fulcrum" fee. There are no similar restrictions on performance fees under existing CFTC or NFA rules.

Limitations on Use of Related Performance Information and Use of Hypothetical Returns

We note that the Petition specifically cites as an example of deficient disclosure (relating to the offering documents of the mutual funds named), the lack of related performance information for underlying CTAs and the investment adviser. However, we note that, under current SEC guidance and FINRA rules, the permitted presentation of related performance information by investment advisers and mutual funds is very limited.[10] While the prospectus for a mutual fund may contain related performance information for a similarly-managed investment company or account, there are limited instances in which this option is available in order to ensure a meaningful comparison for the benefit of investors. In addition, presentation of hypothetical and/or backtested performance is deemed inherently misleading by the SEC and FINRA, and is not permitted in a mutual fund's prospectus.

We note further that, under current CFTC and NFA rules, CPOs are required to show related performance information[11] and may use hypothetical or simulated returns in limited circumstances.[12] This is an example of a clear philosophical difference between the regulatory agencies that highlights the difficulty of imposing commodity pool rules on mutual funds.

Preference by Investors for IRS Tax Form 1099-DIV vs. Schedule K-1

Tax reporting on mutual fund performance is set forth on IRS Tax Form 1099-DIV ("Form 1099") as opposed to Schedule K-1 ("K-1"), which is often delivered by commodity pools. It has been our experience that a serious consideration of investors deciding between a commodity mutual fund and a commodity pool is their overall preference for receiving a Form 1099 rather than a K-1 given the Form 1099's relative ease of administration for tax reporting purposes. In contrast, a K-1 is a more complicated tax form and may not be as timely received by investors in time to meet typical tax filing deadlines.

Mutual Funds' Streamlined Prospectus Delivery

Commodity pools are required to receive signed copies of subscription documents from their prospective investors prior to accepting the investors' funds. This approach is not practical for the mutual fund industry, where mutual funds generally pool funds from hundreds of investors. However, it is important to note that, while the Petition assumes that retail investors in MutualHedge only need to point and click to buy or redeem shares in MutualHedge, investors only have electronic access to MutualHedge through a financial advisor. Moreover, any electronic access to MutualHedge that an investor enjoys is through (i) a

---

[10] *See* NASD Conduct Rule 2210.

[11] *See* CFTC Rule 4.25(a)(3).

[12] *See* CFTC Rule 4.41 and NFA Compliance Rule 2-29.

licensed financial advisor associated with a broker-dealer or (ii) a financial fiduciary such as an independent registered investment adviser.

Streamlined State-Level Approval and Registration Process

As a consequence of the passage of the National Securities Markets Improvement Act of 1996 ("NSMIA"), the process for securities offerings at the state level was vastly improved. NSMIA modernized the relationship between federal and state securities regulators and made the SEC the regulator of nationally-based activities, while preserving the role of states over activities that were truly local in nature. At the same time, NSMIA preserved the right of state regulators to prosecute fraud. Among other things, NSMIA preempts state registration and related requirements in the case of offerings of nationally traded securities and securities of registered investment companies.

NSMIA amended Section 18 of the 1933 Act to provide that no state law requiring the registration or qualification of securities and securities transactions shall, directly or indirectly, apply to a "covered security." Covered securities include, among other things, securities of a mutual fund but do not include the securities of a commodity pool.

The resultant savings from not having to apply to, and seek approval from, each state securities regulator prior to offering securities for sale in that state has resulted in significant savings, as well as, increased efficiency and greater access for mutual fund investors. The lack of a similar streamlined process for the securities of a public commodity pool means increased costs and inefficiency, and lower access for public commodity pool investors.

Mutual Fund Daily Liquidity Requirement

Mutual funds are required to offer daily liquidity to their investors. Most public commodity pools, by contrast, offer monthly liquidity only. This requirement is greatly facilitated by robust industry-wide systems not currently available and/or accessible to commodity pools.[13] Even for public commodity pools that offer daily liquidity, the redemption process is comparatively more complex and different than for mutual funds. A common question asked by investors typically accustomed to mutual fund investments is why the redemption (as well as subscription) process for commodity pools is noticeably more complex and cumbersome. As a result of the daily liquidity requirement, mutual fund investors enjoy an extra layer of risk management associated with the opportunity to exit their investment every trading day.

<u>Other Considerations</u>

In the event that the CFTC ultimately decides to amend Rule 4.5 as requested in the Petition, we urge the CFTC to consider harmonizing conflicting rules and requirements with those of the SEC. For example, under CFTC rules, a commodity pool operator may not accept funds from a prospective investor before first receiving an acknowledgment signed and dated by the investor stating that he or she has received the commodity pool's disclosure document.[14] Similarly, commodity pools with net assets of more than

---

[13] E.g., Fund/SERV.

[14] CFTC Rule 4.21(b).

$500,000 must physically deliver to each investor an account statement on a monthly basis.[15] All commodity pools also require a signature by hand to redeem one's investment.

Mutual funds are not subject to these requirements and, as a practical matter, would be unable to comply with them given their large numbers of investors. If the CFTC were to consider how to harmonize these and other conflicting rules, the exemptive relief previously provided by the CFTC to exchange-traded commodity funds ("commodity futures ETFs") could be a useful precedent. The CFTC, for example, has provided exemptions to CPOs of commodity futures ETFs from the account statement delivery requirements because compliance with the SEC's prospectus delivery requirements provides substantially similar disclosure to investors.

Conclusion

By this comment letter, we have sought to respectfully advise you of our belief that the existing mutual fund regime has for many years served well those investors who have sought commodity futures alternative investments via commodity mutual funds. The commodity mutual funds specifically cited by the NFA in the Petition are not materially different from commodity mutual funds previously approved. In fact, some such funds even predate the 2003 amendments to Rule 4.5.

Regulation of commodity mutual funds should continue to be the primary jurisdiction of the SEC in order to avoid duplicative and/or conflicting rules. Most importantly, a mere layering on of an additional body of rules and related disclosures may defeat the goal of providing clear, plain English offering documents to investors, and may add another layer of costs and expenses for these investors. It is our view that the established precedent over the past several years, in which the SEC has regulated commodity mutual funds and the CFTC has regulated commodity pools, has been clearly successful and strongly supports the position that Rule 4.5 should remain unchanged from its current form. To the extent certain additional disclosures may be required to address specific concerns involving commodity mutual funds, we believe that rules requiring such disclosures could be addressed within the existing 1940 Act regime and subject to SEC regulation and enforcement.

To the extent we can be helpful in answering any questions the CFTC and/or the NFA may have, and/or participate in any other way as requested, we would welcome such opportunity. By virtue of our position as both a registered investment adviser to a commodity mutual fund, and separately as a CPO to a public commodity pool, we feel we may be able to meaningfully so contribute. Should you have any questions regarding this letter, please do not hesitate to reach me by phone at (303) 837-0600 and by email at pliu@equinoxllc.com.

Very truly yours,

Philip Liu
General Counsel

---

[15] CFTC Rule 4.22(b).