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February 22, 2011

Submitted via the Federal eRulemaking Portal at http://www.regulations.gov

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

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549–1090

Re: Definitions: Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant" (SEC File Number S7-39-10)

Dear Secretaries Stawick and Murphy:

We are writing on behalf of a group of our clients (the "FOF Managers") that manage private investment funds-of-funds ("FOFs") that primarily invest in other private investment funds or managed accounts ("Portfolio Funds"). This group of FOF Managers collectively represents approximately $50 billion in assets under management. We are writing in response to the joint notice of proposed rulemaking (the "Proposed Rules")[1] issued by the Commodity Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission (the "SEC" and together with the CFTC, the "Commissions") on December 1, 2010 and December 7, 2010,

[1] Further Definition of "Swap Dealer," Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant" Proposed Rule; 75 Fed. Reg. 80174, 80174 (to be codified at 17 C.F.R. pts. 1 and 240) (Proposed Dec. 21, 2010).

respectively, proposing certain important "entity" definitions required by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[2]

We believe the Proposed Rules are one of the most important rulemakings the Commissions will undertake in implementing Title VII of Dodd-Frank and we applaud the meticulous level of detail applied by the Commissions in many portions of the Proposed Rules. We appreciate this opportunity to express our views and concerns about the proposed changes to the definition of eligible contract participant ("ECP"), as applied to FOFs engaged in off-exchange transactions in foreign currency ("OTC forex") pursuant to Section 2(c) of the Commodity Exchange Act (the "CEA"). However, we believe the Proposed Rules will adversely affect the FOF industry and, in particular, the industry's ability to raise capital from non-U.S. investors. The Proposed Rules, as applied to FOFs, are unlikely to further the Commissions' very important interests in ensuring that retail investors are protected from the unscrupulous practices that appear all too common in the OTC forex markets.

Concerned about the potentially significant industry disruptions which we believe are likely to result from the Proposed Rules, we strongly recommend:

(1) (a) that the CFTC continue to allow commodity pools that do not meet the new retail forex look-through provision added by Dodd-Frank to rely instead on the entity prong of the ECP definition; (b) that the CFTC adopt a new rule clarifying that commodity pools comprised entirely of "qualified eligible persons" ("QEPs") and operated by persons subject to regulation under the CEA are ECPs; and/or (c) that the CFTC adopt a new rule that commodity pools that (i) have $50,000,000 or more in net assets or require a minimum initial investment of at least $1,000,000, (ii) are not formed for the purpose of directly engaging in OTC forex transactions and (iii) are operated by persons subject to regulation under the CEA, are ECPs; and

(2) that the CFTC deem non-U.S. persons to be ECPs by definition; and

(3) that the CFTC provide that FOFs are ECPs if they are not formed for the purpose of directly trading OTC forex, use OTC forex solely for hedging purposes and are operated by persons subject to regulation under the CEA that advise, on an aggregate basis, $50,000,000 in total assets; and

(4) that commodity pools and their counterparties be entitled to rely on ECP representations provided on initial investment for the duration of such investment, provided that each participant in the commodity pool covenants to update such ECP representation if it becomes inaccurate.

For the reasons outlined in this letter, we are confident that these recommendations will prevent a potentially serious, and unintended, disruption to the manner in which numerous firms have done business for many years without incident, while addressing the regulatory concerns of both Congress and the Commissions. Of course, if any of these recommended provisions in fact becomes a means of evading the purposes of Dodd-Frank and the Commissions, it can be

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[2] Pub. L. No. 111-203, §§721 and 761.

revoked. We are not suggesting that the Commissions create "loopholes" in the regulatory scheme, but rather, we recommend that the Commissions proceed with caution so as to avoid potentially disruptive market turmoil.

Background: FOFs and Transactions in Foreign Currency

FOFs are, by definition, operated primarily for the purpose of investing in Portfolio Funds. Most FOF Managers offer exposure to their investment programs to non-U.S. persons via entities formed outside of the United States ("Non-U.S. Funds"). Because most Portfolio Funds accept investments only in U.S. Dollars, most FOFs generally account for their assets and liabilities in U.S. Dollars. However, a significant number of non-U.S. investors whose functional currency is not the U.S. Dollar seek to invest in FOFs in their own currencies. FOFs accommodate these investors by issuing separate classes in the Non-U.S. Funds or by forming feeder funds into the Non-U.S. Funds, in each case that issue shares or interests denominated in currencies other than the U.S. Dollar ("Foreign Currency Classes").

In order to allow investors in the Foreign Currency Class to invest in Portfolio Funds, the FOF Manager converts the foreign currency to U.S. Dollars, and invests those U.S. Dollars into Portfolio Funds. Absent a hedging transaction intended to reduce the risk of changes in the rate of exchange between an investor's functional currency and U.S. Dollar, the value of the investment in the Foreign Currency Class would change based not just on the skill of the FOF Manager in selecting Portfolio Funds and the performance of the Portfolio Funds in U.S. Dollars but also based on changes in that rate of exchange.

FOFs typically hedge exchange rate risk on behalf of Foreign Currency Classes through one-month foreign currency forward rate agreements, although they may use other types of OTC forex transactions that are exempt from the CEA pursuant to Section 2(c)(1) thereof. FOFs typically settle with counterparty dealers in those OTC forex transactions each month and then adjust the trade size for the next month to reflect changes in the Foreign Currency Class' net asset value in an effort to keep the hedge sized appropriately. The counterparties to these OTC forex transactions are normally subsidiaries of U.S. and international banks that regularly quote and transact in trillions of dollars of foreign currency transactions in the interbank and other markets. As subsidiaries of regulated entities, those counterparties have more flexibility than futures commission merchants ("FCMs"), broker-dealers or other similarly regulated entities to offer different duration hedging contracts and to provide pricing in their transactions with FOFs that reflects only market supply and demand factors and risk assessments—they do not have regulatory capital costs that must be passed through to FOFs in the form of wider spreads or through other mechanisms that would increase the costs of hedging for Foreign Currency Classes.

FOF Managers' transactions in OTC forex are therefore largely mechanical transactions undertaken solely for hedging purposes and are intended to reduce risk rather than speculate on currency movements.

Exchange-traded futures contracts are not a cost-effective or practical way for FOFs to hedge exchange rate risk. The markets for exchange-traded futures contracts are not as deep and liquid as the OTC forex market. In addition, exchange-traded futures require the payment of initial and

daily variation margin between the FOF and its FCMs. Initial margin increases the cost of trading as the cash deposited with FCMs cannot be used to invest in Portfolio Funds. To the extent a FOF intended to compensate for such opportunity costs, it would have to borrow. Similarly, it would be quite unusual for a FOF to invest in a Portfolio Fund that provided the daily liquidity necessary to allow the FOF to make variation margin payments. Instead, Portfolio Funds typically offer redemptions only at the end of a calendar month or quarter and only with significant prior notice (*e.g.*, 30 to 90 days). Thus, the typical FOF lacks liquid capital from which to draw to finance an exchange-traded currency hedge on a daily basis. The investors in Foreign Currency Classes would be opposed to FOFs maintaining the substantial cash reserve that would be necessary to manage daily mark-to-market payments because such a reserve would diminish the assets of the FOF available for investment in Portfolio Funds. For all of these reasons, FOFs typically utilize OTC forex transactions that are highly negotiated to enable them to hedge the foreign exchange risk of Foreign Currency Classes consistent with the liquidity profile of the FOFs' investments in their Portfolio Funds.

Regulatory Framework: ECPs and Dodd-Frank

The CEA currently has eleven separate "prongs" under which a person may qualify as an ECP. Two of those prongs are potentially relevant to FOFs: (1) the "commodity pool prong" and (2) the "entity prong."

Pursuant to Section 1a(18)(A)(iv) of the CEA, as renumbered by Dodd-Frank, a commodity pool acting for its own account is an ECP if it has total assets exceeding $5,000,000 and is formed and operated by a person subject to regulation under the CEA or a foreign person performing a similar role or function and subject to foreign regulation. We refer to this as the "commodity pool prong" of the ECP definition. Historically, a commodity pool was able to meet this test regardless of whether each investor in the commodity pool was itself an ECP. However, Dodd-Frank added a "look-through" to the commodity pool prong. Effective July 16, 2011 a commodity pool in which any participant is not itself an ECP will be treated as a non-ECP (*i.e.*, a retail customer) for purposes of Sections 2(c)(2)(B)(vi) and 2(c)(2)(C)(vii) of the CEA. Such a "retail commodity pool" will be subject to severe restrictions on its OTC forex trading under the CEA and CFTC regulations.

We fully appreciate the policy that informed Congress' decision to make this change – *i.e.*, to prevent unscrupulous OTC forex market participants from avoiding the retail commodity provisions of Sections 2(c)(2)(B) and (C) of the CEA and the CFTC's OTC forex rules promulgated thereunder by "engineering" an ECP by pooling the capital of a large group of retail customers, thereby depriving those retail customers of the special protections otherwise afforded to them under the CEA and CFTC regulations. However, we believe the CFTC should take certain actions to mitigate the adverse, and we believe unintended, consequences to FOFs of the look-through.

Pursuant to Section 1a(18)(A)(v) of the CEA, as renumbered by Dodd-Frank, in relevant part, a corporation, partnership, proprietorship, organization, trust or other entity acting for its own

account is an ECP if it has total assets exceeding $10,000,000.[3] We refer to this as the "entity prong" of the ECP definition. Dodd-Frank did not alter the entity prong.

The CFTC is proposing by rule a definition of ECP to supplement the statutory definition in Section 1a(18) of the CEA, as amended and renumbered by Dodd-Frank. We believe the proposed definition in CFTC Proposed Rule 1.3(m)(1)-(4) fills important gaps left by Congress by ensuring that major swap participants, major security-based swap participants, swap dealers and security-based swap dealers are treated as ECPs. We applaud the CFTC's expansion of the ECP definition beyond what Congress specifically contemplated to reflect the CFTC's judgment that these persons ought to be included within the definition. However, we believe that CFTC Proposed Rule 1.3(m)(5) is not a wise expansion on what was specifically contemplated by Congress and that the CFTC should carefully reconsider this Proposed Rule.

The CFTC is proposing that "[a] commodity pool with one or more direct or indirect participants that is not an eligible contract participant [would not be] an eligible contract participant for purposes of Sections 2(c)(2)(B)(vi) and 2(c)(2)(C)(vii) of the Commodity Exchange Act."[4] This would be the case notwithstanding whether the commodity pool meets one of the other ten prongs of the ECP definition available to persons acting for their own accounts (including the entity prong). The rationale for this Proposed Rule is to prevent a commodity pool that does not meet the commodity pool prong of the ECP definition for purposes of the OTC forex "look-through" from relying instead on the entity prong of the ECP definition.[5] In its cost-benefit analysis, the CFTC indicates that it views both of these changes as "clarifying changes that are not expected to have substantive effects on market participants."[6] We strongly disagree with this statement and believe that not only do these changes substantially alter the ECP definition, as clearly written by Congress, but that these changes also, in fact, have a substantive effect on market participants, constitute a change from current practice and will have an adverse impact on many legitimate market participants, particularly FOFs.

<u>Recommendation One: Commodity Pools Should be Permitted to Rely on Different Prongs of the ECP Definition</u>

Given the foregoing, we do not think it is reasonable to believe that when Congress provided eleven different ways for a person acting for its own account to be an ECP that it intended the failure to qualify for one of the eleven prongs as being definitive with respect to the ECP status of that person. We think that preventing a commodity pool that does not meet the commodity pool prong ECP look-through test from being treated as an ECP pursuant to the entity prong is contrary to Congress' clearly expressed intent. Had Congress wished to preclude commodity pools from relying on the entity prong, it would have made the prong available to "a corporation, partnership, proprietorship, organization, trust, or other entity, *other than a commodity pool*" or

[3] *Id.* at § 1a(18)(A)(v).

[4] Proposed Rule 1.3(m)(5).

[5] *See* 75 FR at 80185.

[6] 75 FR at 80203.

would have otherwise specified that each category is exclusive for the persons defined in that category. For example, the definition of "eligible commercial entity" specifically provides only one criterion that collective investment pools (*i.e.*, commodity pools) may utilize to meet that statutorily defined term. However, Congress clearly did not so limit the definition of ECP, and the statutory definition of ECP is clearly drafted in the alternative.

Further, our understanding of the structure of the eligibility criteria for ECPs, and our reading of the terms of ECP, since the enactment of the Commodity Futures Modernization Act of 2000 ("CFMA"), has been that the baseline standard for all potential market participants has been a $10,000,000 total assets test, with certain specifically enumerated exceptions. In general, the exceptions provide for certain *lower* total assets tests, or drop the total assets test entirely, for experienced entities and sophisticated market participants, such as financial institutions, insurance companies, registered investment companies, employee benefit plans subject to the Employee Retirement Income Security Act of 1974, as amended, and commodity pools formed and operated by persons subject to regulation under the CEA. A commodity pool, like a registered investment company or an employee benefit plan, is a pool of assets from investors of varying (and, in some cases, undetermined) levels of sophistication that are advised by a sophisticated adviser. In the foregoing instances, Congress saw fit to lower the total assets thresholds because of the sophistication of the professional advisers. We find it illogical to suggest, given that lower total asset standards are available, that one of these entities could not fulfill the requirements of an alternative, higher total assets standard set forth in the statute. Dodd-Frank did not alter the definition of ECP with respect to registered investment companies, employee benefit plans or the other sophisticated market participants listed above, nor did it alter the standard available to other entities listed in Section 1a(18)(A)(v) of the CEA. There seems no compelling reason to treat commodity pools worse than other sophisticated market participants with respect to OTC forex, and no reason to treat them worse than a corporation or other entity with only $10,000,000 in total assets that trades OTC forex and may have no particular expertise in such markets. Therefore, consistent with the plain meaning of the statute, we respectfully request that the CFTC re-evaluate and eliminate sub-clause (5) of Proposed Rule 1.3(m).

If the CFTC believes that commodity pools should be treated differently because there is some risk that those vehicles, in comparison to the other ten eligible kinds of participants, are more likely to facilitate a fraudulent scheme, then we would suggest that an ECP look-through is not necessarily the proper, and certainly not the only proper, standard for attempting to reduce such risk.

Since enactment of the CFMA, the ECP definition has been central to each of the exemptions for OTC derivatives, most of which were eliminated by Dodd-Frank. Prior to Dodd-Frank, a person was required to be an ECP in order to enter into transactions pursuant to Sections 2(d), 2(h) or 2(g) of the CEA, as well as other provisions. ECP status has to date been used as a means to determine whether a given person is sufficiently sophisticated to participate directly in the OTC derivatives markets.

With the addition of a look-through to the commodity pool prong, the ECP definition will now be used to determine the minimum accreditation standard for passive investors to participate indirectly in the OTC derivatives markets (in this case, in the OTC forex markets) through a

pooled investment vehicle. We think the primary purpose of requiring participants in a commodity pool to be ECPs in order for the commodity pool in which they are invested to trade in OTC forex instruments without being subject to Sections 2(c)(2)(B) or (C) and CFTC regulations promulgated thereunder is to protect the investors themselves from potentially fraudulent or abusive treatment at the hands of the operator of the commodity pool. Protection of passive investors in pooled investment vehicles is a laudable goal and one that has already been undertaken in other contexts by both the SEC and CFTC. Indeed, commodity pools are already subject to substantial limitations under the federal securities and commodities laws with respect to the types of investors that may invest in such funds. The "accredited investor" standard, as defined under Rule 506 in Regulation D under the Securities Act of 1933, as amended (the "Securities Act"), and the QEP standard, as defined in CFTC Rule 4.7, are two ubiquitous eligibility criteria and both well-established means of ascertaining the appropriateness of participation in a commodity pool that may engage in alternative investment strategies. Further, many existing commodity pools have already obtained these representations and could efficiently and effectively implement compliance procedures for such a look-through. Alternatively, virtually no commodity pools currently obtain ECP representations from their investors. Obtaining such representations for existing pools would impose a substantial operational burden and additional costs as well as requiring commodity pools to redeem unilaterally their non-ECP, but nevertheless sophisticated, investors for no good reason, and provide little additional benefit with respect to increasing the level of sophistication in the investor base of such commodity pool. Given that $1.9 trillion of assets are currently estimated to be invested in hedge funds,[7] substantial time and expense would be expended in determining new eligibility requirements from the many thousands of investors comprising that portion of these assets under management that utilize OTC forex, which is likely very substantial.

Thus, if the CFTC determines not to eliminate clause (5) of Proposed Rule 1.3(m) entirely, we propose that clause (5) be revised to read that a "commodity pool all of whose participants are qualified eligible persons, as defined in §4.7, operated by a person subject to regulation under the Commodity Exchange Act and which has a net asset value of no less than $10,000,000 is an eligible contract participant for purposes of Section 2(c)(2)(B)(vi) and 2(c)(2)(C)(vii) of the Commodity Exchange Act."

Alternatively, we suggest that the CFTC adopt a new clause in Proposed Rule 1.3(m) for which the total assets of the pool or the minimum initial investment for the pool would be sufficiently large that, in general, only legitimate pools would exceed such thresholds. Larger pools will inevitably attract significant accounting, legal and regulatory attention, and are unlikely to be formed solely to avoid the OTC forex restrictions. Based on a review of recent CFTC cases brought with respect to commodity pools for frauds relating to OTC forex,[8] a $50,000,000

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[7] *See* Hedge Funds End 2010 with Record Quarterly Asset Increase, Hedge Fund Research, Inc. (January 19, 2011), available at https://www.hedgefundresearch.com/pdf/pr_20110119.pdf.

[8] *See, e.g., the following CFTC cases:* $1.4 million (CFTC v. Larry Benny Groover, et al.); $35 million (CFTC v. Keith Simmons, et al.); $669,000 (CFTC v. PMC Strategy, LLC, et al.); $37 million (CFTC v. Beau Diamond et al.); $650,000 (CFTC v. Anthony Eugene Linton); $3.3 million (Order: Darren Lee Shanks and Forex Auto Profits, LLC); $535,000 (CFTC v. FX Professional International et al.); $25 million (CFTC v. CRE Capital Corporation et al.); $28 million (CFTC v. MXBK Group et al.); $3.3 million (CFTC v. Ronald E. Satterfield et al.); $3.3 million (CFTC v. Graham Street Forex Group, et al.); $8.1 million (CFTC v. Complete Developments, et al.); $808,000

threshold or minimum initial investment of at least $1,000,000 appear to be sufficiently high benchmarks for presuming legitimacy for these commodity pools. Such provisions could require that the pool not be formed for the purpose of engaging directly in OTC forex. As noted above, we would not consider a FOF that has Foreign Currency Classes (even in the context of a feeder fund formed solely for offering interests in a currency other than U.S. Dollars) to be formed for the purpose of engaging directly in OTC forex – these OTC forex trades are ancillary to the real purpose of investing in Portfolio Funds, done for the convenience of (and at the request of) non-U.S. investors. Thus, we propose that the following provision be added to Proposed Rule 1.3(m):

> "A commodity pool with $50,000,000 or more in net assets or that requires a minimum initial investment of no less than $1,000,000, in either case, that was not formed for the purpose of directly engaging in transactions described in Sections 2(c)(2)(B) or 2(c)(2)(C) of the Commodity Exchange Act, and that is operated by a person subject to regulation under the Commodity Exchange Act is an eligible contract participant for purposes of Sections 2(c)(2)(B)(vi) and 2(c)(2)(C)(vii) of the Commodity Exchange Act."

For purposes herein, we would view a FOF Manager that is registered as a commodity pool operator with the CFTC or a FOF Manager exempt from registration with the CFTC pursuant to CFTC Rule 4.13(a)(3) or 4.13(a)(4) as subject to regulation under the CEA.

Recommendation Two: The ECP Definition Should Include Non-U.S. Persons

There is no "non-U.S. person prong" of the ECP definition at present. When ECP status was applied only directly to OTC market participants, a sound policy-based rationale could be advanced not to include non-U.S. persons as a separate category of ECPs. Such persons could easily transact outside of the United States and therefore avoid entanglement with the U.S. regulatory jurisdiction entirely. However, to the extent that a non-U.S. person engaged in OTC transactions with U.S. persons, those direct activities could themselves have an adverse impact on their U.S. counterparties, other customers of the U.S. counterparties or the U.S. OTC markets generally.

Now that the ECP definition is being used as an accreditation standard for passive investors in a commodity pool, however, we think non-U.S. persons should be deemed ECPs by definition, pursuant to CFTC rule, at least insofar as it relates to the look-through in Section 1a(18)(A)(iv)(II) of the CEA. As noted above, with respect to protecting investors from

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(CFTC v. Total Call Group Inc., et al.); $3 million (CFTC v. Integra Capital Management, LLC, et al.); $1.8 million (CFTC v. Peoples Alternative, Inc. et al.); $4 million (CFTC v. Billion Coupons Inc., et al.); $1 million (CFTC v. Jeremiah C. Yancy, et al.); $30 million (CFTC v. Growth Capital Management, et al.); $535,000 (CFTC v. FX Professional International Solutions, et al.); $4.3 million (CFTC v. Highlands Capital, et al.); $4.5 million (CFTC v. CMA Capital Management, LLC, et al.); dollar amount not cited (CFTC v. Cyber Market Group, LLC et al.); $700,000 (CFTC v. Yellowstone Partners, Inc., et al); $280,000 (CFTC v. Helmut H. Weber, et al.); $800,000 (CFTC v. Safeguard, et al.); $200,000 (CFTC v. Willie Lee Cloud, et al.); $190 million (CFTC v. Trevor Cook, et al.)

fraudulent or abusive treatment by a commodity pool operator, there are already substantial relevant eligibility restrictions and rules from both the CFTC and SEC.

Securities Act Requirements

FOFs are generally private investment funds that are prohibited from engaging in public solicitation, and are, in general, not open to investment by the retail public in the United States. For the purposes of the Securities Act, FOFs generally offer their securities in private placements in the United States pursuant to the safe harbor provided by Rule 506 of Regulation D for "transactions by an issuer not involving any public offering." The SEC has enacted Regulation S under the Securities Act, which provides that offers and sales by a non-U.S. issuer to non-U.S. persons are also exempt from the registration requirements of the Securities Act. Many FOF Managers set up non-U.S. entities to facilitate investment by non-U.S. persons, thereby allowing those non-U.S. persons to invest without having to meet any particular financial threshold or standard for accreditation beyond merely being non-U.S. persons.

Investment Company Act Requirements

Absent Sections 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940, as amended (the "ICA"), FOFs would be treated as "investment companies" and would be required to register as such with the SEC or not offer interests in the United States. Section 3(c)(1) provides an exclusion from the definition of "investment company" for issuers whose outstanding securities are beneficially owned by no more than 100 persons and that are not making or presently proposing to make a public offering of their securities. Section 3(c)(7) of the ICA provides a further exclusion from the definition of "investment company" for issuers whose outstanding securities are owned exclusively by "qualified purchasers"[9] and that are not making or presently proposing to make a public offering of their securities. Through a series of no-action letters,[10] the SEC has held that a non-U.S. issuer seeking to rely on 3(c)(1) or 3(c)(7) for exclusion from the definition of "investment company" need not count its non-U.S. person investors toward the 100 person limit for purposes of 3(c)(1) or require that its non-U.S. person investors be qualified purchasers for purposes of 3(c)(7).

Commodity Exchange Act Requirements

Most FOFs are also treated as commodity pools due to the activities of the Portfolio Funds in which they invest, and FOF Managers are often registered as commodity pool operators ("CPOs").[11] In Section 4.7 of the CFTC's regulations, the CFTC has provided registered CPOs

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[9] Qualified purchasers" include, among others, natural persons with no less than $5 million in net investments, and entities that own and invest on a discretionary basis not less than $25 million in net investments. ICA § 2(a)(51).

[10] *See, e.g.*, Touche, Remnant & Co., SEC No Action Letter (pub. avail. August 27, 1984).

[11] Note that many FOF Managers are currently exempt from registration as CPOs pursuant to Section 4.13(a) of the CFTC's regulations. We appreciate that the CFTC has proposed to eliminate certain portions of Section 4.13(a) on which many FOFs rely, however, we believe if the proposed changes are adopted many FOFs will seek to rely on the relief provided to registered CPOs by CFTC Regulation 4.7, which contemplates participation by non-U.S. persons.

with relief from many of the detailed disclosure, reporting and recordkeeping requirements otherwise applicable to registered CPOs. In order for a registered CPO to rely on Section 4.7, participation in a commodity pool must be limited to QEPs. Non-U.S. persons are, by regulation, QEPs.[12]

Given that regulatory standards described above allow a FOF to accept passive investments from non-U.S. persons, it strikes us as incongruous that the ECP definition, now that it is also being used as an accreditation standard for passive investors, would not include non-U.S. persons for the limited purpose of the OTC forex look-through. As described previously in this letter, to the extent that a FOF Manager undertakes foreign currency hedging transactions, such transactions are usually done on behalf of Foreign Currency Classes in Non-U.S. Funds in which non-U.S. persons are invested. Thus, excluding investors in commodity pools who are non-U.S. Persons, as defined under CFTC Rule 4.7 (or Regulation S or a combination thereof), would provide real and meaningful relief to FOF Managers (who are likely either already registered CPOs or exempt CPOs pursuant to Rule 4.13). Furthermore, given the nature of a FOF—a fund whose purpose is to invest in other Portfolio Funds rather than to engage in direct, speculative trading—there seems little to suggest that OTC forex transactions pose any greater risk to investors in a FOF than any other kind of transaction undertaken directly or indirectly by a FOF. To the contrary, because such transactions are merely hedging transactions designed to eliminate to the extent practicable the risk of foreign currency movements between the U.S. Dollar and the investor's functional currency, there appears to be no reason to impose specific protections. Also, given the limited purposes for which FOFs utilize OTC forex, there does not appear to be any need to draft any specific provisions limiting the availability of a non-U.S. person prong to FOFs; if direct trading managers engaged in OTC forex transactions to any real extent they would generally do so on behalf of both non-U.S. and U.S. persons, applying the Congressional look-though as intended.

We understand from our clients and from our own experience advising on transactions that many non-U.S. Persons insist on FOFs providing classes of interests in their functional currency and further that such FOF Managers undertake to reduce the risk of foreign exchange rate fluctuations between that currency and the base currency of the FOF. We further understand that there is often resistance with respect to non-U.S. persons providing eligibility representations related to U.S. rules with respect to investments in non-U.S. issuers – such non-U.S. persons do not readily grasp the U.S. jurisdictional nexus. Thus, implementing the ECP rule without adding non-U.S. persons as a separate eligibility criterion (at least with respect to the Section 1a(18)(A)(iv)(II) look-through) would likely have an adverse effect on U.S.-based FOF Managers obtaining investments from non-U.S. persons (who often refuse to invest in products not offered in their functional currency and hedged into the FOF's base currency and/or are reluctant to provide eligibility representations they do not understand or cannot meet because they do not need to fulfill such requirements for any other purpose).

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[12] QEPs include, among others, certain regulated entities, certain entities with total assets in excess of $5 million, natural persons with individual net worth exceeding $1 million (alone or with a spouse) or income in excess of $200,000 in each of the two most recent years (or joint income a spouse in excess of $300,000 over the same period). CFTC Regulation § 4.7.

Thus, we respectfully request that the CFTC consider adding non-U.S. persons as a separate eligibility category for ECPs, consistent with Congressional, SEC and CFTC approaches embodied in Regulation S, the ICA and CFTC rules. We propose a subsection under Proposed Rule 1.3(m) that reads, "For purposes of Section 1a(18)(A)(iv)(II) [or any related regulations], a Non-United States Person, as defined in §4.7, is an eligible contract participant."

Recommendation Three: FOFs Should be Defined as ECPs for the purposes of Hedging Foreign Exchange Risk on Behalf of Their Investors

Given that FOFs generally invest all or substantially all of their assets in underlying Portfolio Funds, and given that direct OTC forex transactions are done to reduce foreign exchange exposure and risk, as described above, we also specifically request that the CFTC add an additional prong to the definition of ECP relating to FOFs themselves. The definition of a FOF utilized by the SEC with respect to interpreting SEC Rule 206(4)-2[13] is a useful starting place for a definition for these purposes; however, rather than a 10% threshold, we think it sufficient instead to utilize a "primary purpose" test.

In short, FOF Managers (which are, or likely will be given the relevant provisions of Dodd-Frank, registered investment advisers and CPOs) are already subject to extensive and substantive regulation. Furthermore, a FOF's primary purpose is not the solicitation of capital to engage directly in speculative OTC forex transactions. On the contrary, OTC forex transactions undertaken directly by FOF Managers, as described above, are not speculative and are clearly not the sort of transaction that Congress intended to capture through the addition of a look-through in Section 1a(18)(A)(iv)(II) or that the CFTC, we presume, intends to regulate through the Proposed Rules. Further, we are unaware of any specific investor protection problems or concerns that have occurred or are prevalent in this context.

Moreover, causing FOFs to engage in foreign exchange transactions on exchanges or only with the counterparties set forth in Section 2(c)(2)(B), all of which are subject to substantial net capital requirements and charges, will increase the costs to such FOFs and their investors. While OTC forex transactions may be highly negotiated initially, such arrangements generally provide for efficient execution of transactions on an ongoing basis thereafter without incurring exchange fees or bearing some portion of the overhead costs related to net capital requirements and charges. Additionally, FOFs would incur substantial counterparty, documentation and operational costs in moving their trades from OTC forex onto exchanges or toward the counterparties set forth in Section 2(c)(2)(B). Many of these costs would be passed through to investors. Therefore, we respectfully request that the CFTC add an additional item to the definition of ECP such that for purposes of direct OTC forex transactions for hedging purposes, as described herein, FOFs be considered ECPs and that the FOF Managers not be subject to regulation pursuant to Part 5 of the CFTC Rules. For these purposes, we would not look through

[13] The SEC defines a "fund of funds" as a "limited partnership (or limited liability company, or another type of pooled investment vehicle) that invests 10 percent or more of its total assets in other pooled investment vehicles that are not advised by, a related person . . . of the limited partnership, its general partner, or its adviser." *See* ABA Committee on Private Investment Entities, SEC Staff Letter (Aug. 10, 2006), available at http://www.sec.gov/divisions/investment/noaction/aba081006.pdf.

to the activities of any Portfolio Funds (including any managed accounts) accessed by the FOF. We propose the following rule:

> "A limited partnership, limited liability company or another type of pooled investment vehicle whose primary purpose is to invest in other pooled investment vehicles or managed accounts that are not advised by a related person: (a) that is not formed for the purpose of directly engaging in transactions described in Sections 2(c)(2)(B) or 2(c)(2)(C); (b) that engages in transactions described in Sections 2(c)(2)(B) and 2(c)(2)(C) solely for hedging purposes; and (c) that is operated by a person (i) subject to regulation under the Commodity Exchange Act and (ii) that advises, in the aggregate, at least $50,000,000 in total assets is an eligible contract participant for purposes of directly engaging in transactions described in Sections 2(c)(2)(B) and 2(c)(2)(C) for purposes of Sections 2(c)(2)(B)(vi) and 2(c)(2)(C)(vii) of the Commodity Exchange Act."

Recommendation Four: Clarify the Manner of Complying with the OTC Forex Look-Through

To the extent that the proposed rules remain largely unchanged, we are concerned about the fact that FOFs currently obtain investor eligibility representations upon subscription but generally do not reconfirm or renew such representations on an ongoing basis (except for representations on "restricted" person status under Rule 5130 of the Financial Industry Regulatory Authority, Inc.). We propose that the CFTC adopt by rule, or otherwise clarify in the adopting release or other interpretative notice, that commodity pools and their counterparties may rely on ECP representations made by participants in the commodity pool each time such participants make an investment decision, so long as those participants covenant to update the commodity pool if the ECP representation ceases to be accurate.

We greatly appreciate the Commissions' consideration with regard to the foregoing comments.

Very truly yours,

Bradley D. Howard