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April 11, 2011

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

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

Re: **Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations (RIN 3038—AD30)**

Dear Secretary Stawick:

We are writing on behalf of a group of our clients (the "**Securities-Based FoF Managers**") that manage, in the aggregate, approximately $50 billion in assets for private investment funds[1] (**"Securities-Based FoFs"**) that invest primarily in underlying private investment funds or managed accounts ("**Portfolio Funds**") managed by unaffiliated investment professionals ("**Portfolio Managers**").

We are writing in response to the notice of proposed rulemaking (the "**Proposing Release**") issued by the Commodity Futures Trading Commission (the "**Commission**") on February 11, 2011, to urge the Commission to:

(A) Retain the Rule 4.13(a)(4) exemption from commodity pool operator ("**CPO**") registration for any Securities-Based FoF Manager that:

[1]Most of these private investment funds are not registered as investment companies under the Investment Company Act of 1940, as amended (the "**ICA**"), either because they are excluded from the definition of "investment company" under Section 3(c)(7) of the ICA, or are not subject to registration under the ICA because they are organized outside the U.S. and offered exclusively to non-U.S. investors. However, certain of these private investment funds, while privately offered, are registered as "closed-end" investment companies under the ICA.

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-- is registered with the Securities and Exchange Commission ("**SEC**") as an investment adviser under the Investment Advisers Act of 1940, as amended (the "**Advisers Act**");

-- invests 75% or more of the capital of each Securities-Based FoF for which such Securities-Based FoF Manager claims exemption from registration under Rule 4.13(a)(4) in interests in "private funds" (*i.e.*, Section 3(c)(1) or Section 3(c)(7) funds which, by definition, must primarily trade securities) or their offshore equivalents that are advised by Portfolio Managers that are:

› registered, or exempt from registration, with the SEC as investment advisers (or are not subject to registration with the SEC as investment advisers); and

› registered, or exempt from registration, with the Commission as CPOs (or are not subject to registration with the Commission as CPOs);

-- trades commodity futures or commodity options contracts for each Securities-Based FoF for which such Securities-Based FoF Manager claims exemption only to the extent that the aggregate initial margin and premiums required to establish the commodity interest positions of the Securities-Based FoF, determined at the time the most recent position was established, does not exceed 5 percent of the liquidation value of the Securities-Based FoF's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into (provided, that in the case of an option that is in-the-money at the time of purchase, the in-the-money amount may be excluded in computing such 5 percent); and

-- does not market any Securities-Based FoF for which such Securities-Based FoF Manager claims exemption from registration under Rule 4.13(a)(4) as a commodity pool or otherwise as a vehicle for primarily trading in the commodity futures, commodity options or swaps markets **("Qualified Securities-Based FoF Managers"**).

AND

(B) Exempt Securities-Based FoFs that are registered as investment companies under the ICA ("**RICFoFs**") from the proposed amendments to Rule 4.5, subject to certain restrictions discussed below.

Rule 4.13(a)(4)

Our request to retain the Rule 4.13(a)(4) exemption from CPO registration is limited solely to Qualified Securities-Based FoF Managers that comply with the restrictions described above in respect of each Securities-Based FoF for which such a Securities-Based FoF Manager claims exemption from registration under Rule 4.13(a)(4).

As discussed below, rescinding the Rule 4.13(a)(4) registration exemption from CPO registration for Qualified Securities-Based FoF Managers would:

- in no respects further the legislative and regulatory goals of limiting regulatory arbitrage and enhancing transparency;
- place significant and duplicative regulatory requirements on Securities-Based FoF Managers with no discernible increase in the regulatory protection of either the securities markets or investors; and
- unnecessarily burden the oversight resources of both the Commission and the National Futures Association (the "**NFA**").

The Goals of CPO Registration

In the Proposing Release, the Commission explained that the purpose behind eliminating the Rule 4.13(a)(4) exemption is to: (i) limit "regulatory arbitrage" that may exist for some pool operators that may be able to avoid oversight by either the Commission or the SEC; and (ii) improve transparency and increase accountability with respect to these pool operators. See page 7985 of Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 76 Fed. Reg. 7976, 7985 (proposed Feb. 11, 2011).

For the reasons set forth below, we do not believe that requiring Qualified Securities-Based FoF Managers to register with the Commission would — or could — meaningfully serve either of these goals.

Regulatory Arbitrage

The objective of limiting "regulatory arbitrage" is to prevent certain market participants from operating without either SEC or Commission oversight (thereby depriving the

Financial Stability Oversight Counsel ("**FSOC**") of data it may require from regulators in order to provide meaningful protections to the financial markets). However, it is clear that no "regulatory arbitrage" is implicated by requiring Qualified Securities-Based FoF Managers to register only with one, not both, of the SEC or the Commission. No "regulatory arbitrage" is implicated by exempting Qualified Securities–Based FoFs from duplicative CPO registration, as Qualified Securities-Based FoF Managers are (by definition) registered as investment advisers with the SEC under the Advisers Act. Neither the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**") nor any of its legislative history suggests a Congressional intent to require that investment advisers registered with the SEC also register as CPOs with the Commission if they are focused primarily on giving securities-related, as opposed to futures-related, advice.

Securities-Based FoFs participate only to a *de minimis* extent directly in the financial markets (as opposed to investing in Portfolio Funds which themselves may or may not participate more extensively in these markets). As investors in Portfolio Funds, such Securities-Based FoFs have minimal, if any, impact on these markets as the Portfolio Funds typically are managed in the complete discretion of third-party Portfolio Fund Managers unaffiliated with the Securities-Based FoF Manager. The Securities-Based FoF Managers impact their clients, not the markets, and the service they perform for their clients is investing in securities (interests in Portfolio Funds), not futures (except perhaps to a *de minimis* extent).

We are not suggesting that Securities-Based FoF Managers that themselves make extensive use of the futures and swaps markets, or that market their Securities-Based FoFs as primarily engaged in investing in the futures or swaps markets, should be exempt from CPO registration with the Commission — such Securities-Based FoFs would <u>not</u> be Qualified Securities-Based FoFs. With respect to such Securities-Based FoF Managers, the Commission's and NFA's regulatory expertise may potentially be more relevant than the SEC's, even though such FoF Managers primarily themselves invest only in securities — *i.e.*, interests issued by Portfolio Funds.

Next, to the extent that the Portfolio Funds in which Securities-Based FoFs invest constitute commodity pools, the Portfolio Managers of such Portfolio Funds will be required to register with the Commission as CPOs. Our proposal does not seek to exempt the Portfolio Managers of such Portfolio Funds from CPO registration.[2]

[2] Of course, to the extent that the Portfolio Funds in which Securities-Based FoFs invest do not constitute commodity pools, the Commission would not appear to have an interest in regulating such Portfolio Funds.

Finally, under our proposal, the Commission would, of course, continue to have jurisdiction over Qualified Securities-Based FoF Managers under the anti-fraud provisions of the Commodity Exchange Act.

In light of the foregoing, we believe that exempting an SEC-registered Securities-Based FoF Manager from CPO registration under the terms and conditions of our proposal will not result in "regulatory arbitrage."

Transparency

Registration of Qualified Securities-Based FoF Managers would not meaningfully increase the transparency of the markets, for several reasons.

First, Securities-Based FoFs already will be required to file Form PF. Proposed Form PF will provide the Commission and the SEC with the relevant information relating to a Securities-Based FoF. Requiring Qualified Securities-Based FoF Managers to register as CPOs will not provide any additional meaningful information to the Commission.

Second, transparency into a Securities-Based FoF's portfolio of Portfolio Funds is essentially meaningless because Qualified Securities-Based FoFs invest substantially all their assets in non-traded, privately-offered interests – i.e., interests in the Portfolio Funds. In themselves, these interests reflect no market activity whatsoever. Interests in these Portfolio Funds do not trade; such Portfolio Funds are privately offered and available for investment only by a strictly limited group of highly sophisticated investors.

Next, the identity of a Portfolio Fund in itself is effectively meaningless — often simply a derivative of the name of the Portfolio Manager — and gives little, if any, indication in what such Portfolio Fund invests, much less of how it affects the financial markets.

Finally, it is generally only at the level of the underlying Portfolio Funds that the markets themselves are affected. At this level, the Portfolio Funds in which the Qualified Securities-Based FoF Managers invest will themselves be subject to transparency requirements (e.g., Form PF) and these Portfolio Funds are, in fact, the advisory vehicle by which Securities-Based FoFs "touch" the investment.

Significant and Duplicative Regulatory Requirements

Absent the Rule 4.13(a)(4) exemption, virtually all Qualified Securities-Based FoF Managers will be required to register, or, in many instances, re-register, as CPOs with the Commission. Commission registration will result in significant initial as well as ongoing administrative burdens to Qualified Securities-Based FoF Managers as well as significant

incremental drain on the limited regulatory resources of the Commission and the NFA. Registration also will increase the cost to the investors in Qualified Securities-Based FoFs due to the additional expenses associated with preparing NFA filings and the additional compliance resources required to maintain dual registration. At the same time, registration will provide little, if any, additional regulatory benefit to investors or to the Commission due to: (i) the nature of the Qualified Securities-Based FoF Managers' investment programs, discussed above; and (ii) the comprehensive SEC regulations and reporting to which they, as well as most if not all of the Portfolio Managers of the Portfolio Funds in which they invest, are subject as registered investment advisers.

Importantly, our proposal is fully consistent with Section 4m3 of the Commodity Exchange Act, as amended by the Dodd-Frank Act. Section 4m3 exempts from Commission registration persons registered as "investment advisers" and "whose business does not consist primarily of acting as a commodity trading advisor . . . and [which] does not act as a commodity trading advisor to any commodity pool that is engaged primarily in trading commodity interests." Congress, in the Dodd-Frank Act, expressly examined whether the purpose underlying 4m3 — eliminating the requirement of duplicative regulatory compliance resulting from dual registration — should be continued (even in light of the clear Congressional intent to increase the scope of regulatory oversight of the financial markets) and affirmed that it should be. The Dodd-Frank Act restated, but did nothing to narrow, the intent of this statutory exemption from commodity trading advisor registration.

Burden on Oversight Resources of Both the Commission and the National Futures Association

We believe that the current material increase in the regulation of "private funds" provides an excellent opportunity for the Commission to permit Qualified Securities-Based FoF Managers to be regulated by the SEC while conserving Commission/NFA resources for the enhanced regulation of those market participants that are active participants in the futures and derivatives markets. We would, however, support a notice filing with the Commission and NFA for Securities-Based FoF Managers, with a requirement that the Qualified Securities-Based FoF Manager notify the Commission and NFA in the event the SEC initiates any action against the Qualified Securities-Based FoF Manager. This is an approach used in various non-US jurisdictions to avoid duplicative regulation while still allowing the secondary regulator to act if the primary regulator detects some problem.

Conclusion

For the last ten years, Rule 4.13(a)(4) has provided important regulatory relief to all Securities-Based FoF Managers, without any indication whatsoever of any regulatory or

investor disadvantage of which we are aware. We urge the Commission to continue this relief for a strictly limited group of heavily regulated indirect market participants — the Qualified Securities-Based FoF Managers.

In summary, rather than eliminating Rule 4.13(a)(4) in its entirety, we urge the Commission to limit its availability to certain Securities-Based FoF Managers. This could be accomplished by simply adding new sections (i) and (ii) to such rule (renumbering existing sections (i)-(v) as (iii)-(vii)) as follows:

> "(i) such pool (A) invests 75% or more of its capital in private funds (or their offshore equivalents), (B) uses commodity futures or commodity options contracts only to the extent that the aggregate initial margin and premiums required to establish the commodity interest positions of such pool, determined at the time the most recent position was established, does not exceed 5 percent of the liquidation value of such pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into (provided, that in the case of an option that is in-the-money at the time of purchase, the in-the-money amount may be excluded in computing such 5 percent), and (C) is not marketed as a commodity pool or otherwise as a vehicle for primarily trading in the commodity futures, commodity options or swaps markets;
>
> (ii) (A) the operator of such pool is registered with the Securities and Exchange Commission as an investment adviser under the Investment Advisers Act of 1940, as amended; (B) the operator of or advisor to each private fund (or each offshore equivalent) in which the pool invests is registered, or exempt from or not subject to registration, with the Securities and Exchange Commission as an investment adviser under the Investment Advisers Act of 1940, as amended, and (C) the operator of or advisor to each private fund (or each offshore equivalent) in which the pool invests is registered, or exempt from or not subject to registration, with the Commission as a commodity pool operator."

Rule 4.5

We enthusiastically support the Commission's proposal to narrow the scope of Rule 4.5(b)(i)'s current "blanket" exemption from commodity pool/CPO status for registered investment companies ("**RICs**"). Such corrective action, in our view (as well as that of numerous industry participants), became appropriate when the SEC changed, in 2008–2009, its longstanding position that an entity which was not definitionally an "investment company" (*i.e.*, primarily engaged in the trading of securities) could not voluntarily register with the SEC as such. Once that precedent was reversed, there were several highly publicized instances of

outright commodity pools being organized as RICs but exempted from the Commission's jurisdiction under Rule 4.5. We see no reason that commodity pools should not be regulated by the Commission, irrespective of whether the SEC permits such pools also to register as investment companies.

We do, however, submit that the Proposing Release revising Rule 4.5(c) goes too far — as, indeed, did Rule 4.5(b)(i) before the 2003 amendments — in that it would include RICFoFs as commodity pools even where such RICFoFs: (i) engage in futures trading, if at all, only to a *de minimis* extent and (ii) invest substantially all of their assets in Portfolio Funds that are overwhelmingly, if not entirely, invested in securities-based strategies.

To ensure anti-avoidance — and prevent RICFoFs that invest primarily in futures funds from claiming the Rule 4.5 exemption — we suggest that the Commission restrict the exemption to RICFoFs that invest 75% or more of their capital in Portfolio Funds that represent themselves as being "private funds" (*i.e.*, Section 3(c)(1) or Section 3(c)(7) funds which, by definition, must primarily trade securities) or their offshore equivalents. As a drafting matter, we would propose simply providing a concluding clause (C) to proposed Rule 4.5(b)(2)(iii) as follows:

> "(C) Clauses (A) and (B) above shall not, however, apply to a registered investment company if: (1) the registered investment company invests 75% or more of its capital in private funds (or their offshore equivalents) and uses commodity futures or commodity options contracts only to the extent that the aggregate initial margin and premiums required to establish the commodity interest positions of such pool, determined at the time the most recent position was established, does not exceed 5 percent of the liquidation value of such pool's portfolio, after taking into account unrealized profits and unrealized losses on any such positions it has entered into (provided, that in the case of an option that is in-the-money at the time of purchase, the in-the-money amount may be excluded in computing such 5 percent); and (2) the operator of or advisor to each private fund (or each offshore equivalent) in which the registered investment company invests is registered, or exempt from or not subject to registration, with the Commission as a commodity pool operator."

We emphasize that no regulatory "gap" would be created by permitting RICFoFs to be exempt from Commission registration, as the SEC comprehensively regulates these entities. Moreover, as these entities -- in order to qualify as RICFoFs -- must focus on investing in securities, not futures, trading strategies, the SEC would seem to be their most appropriate regulator. Finally, as the sponsors of the Portfolio Funds themselves — the entities which actually affect the markets — will almost certainly either be required to register as CPOs (or will

not be required to register because their Portfolio Funds do not trade futures), as discussed above, the RICFoFs' indirect contact within the markets will, in fact, be fully subject to Commission regulation. Perhaps the Commission would also wish to impose a notice filing on RICFoFs as we propose above in the case of Qualified Securities-Based FoF Managers.

In closing, we believe unless RICFoF sponsors are exempted from CPO registration, RICFoFs will cease to exist. This is because the manner in which RICs can be and are marketed is ***fundamentally inconsistent*** with the Commission's rules governing the marketing of commodity pools. RICs — like most securities offerings — are not required to obtain a written acknowledgement from each investor of the receipt of a disclosure document before an investment can be made; the routine trade confirmation process is sufficient. The written acknowledgement procedure is completely infeasible in many brokerage houses except within marketing groups which are typically devoted to "real" futures products (not RICFoFs). To require RICFoFs to be marketed as commodity pools will destroy the viability of this potentially very useful financial product — which many have seen as the only practicable means for smaller investors to access the alternative investment strategies otherwise only available to the high net worth and institutional markets. Prior to the 2003 amendments to Rule 4.5(b)(i), there were very few RICFoFs due to this issue. In now amending the existing Rule 4.5(b)(i), we urge the Commission to do so in a manner which avoids this adverse and unintended result.[3]

Thank you for your consideration of this comment letter.

Very truly yours,

/s/ David R. Sawyier

David R. Sawyier

DRS:cmd

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[3] The Commission's anti-fraud and comparable rules would, of course, be fully applicable to RICFoFs — it is only the marketing restrictions imposed on commodity pools — due to their presumptively "especially speculative" nature (clearly not the case with RICFoFs)— from which RICFoFs must be exempted in order to survive.