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VIA Electronic Delivery and UPS

Mr. David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: **RIN Number 3033-AD30**

Commodity Futures Trading Commission ("CFTC") Notice of Proposed Rulemaking entitled "Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations" (the "Release")

Ladies and Gentlemen:

This letter responds to the CFTC's request for comments on the proposed regulatory amendments to various existing CFTC regulations and one new proposed CFTC regulation as discussed in the Release. Among other things, the Release includes a proposal to reinstate the pre-2003 operating restrictions of CFTC Rule 4.5 ("Rule 4.5," and the "Rule 4.5 Proposal").[1] The comments expressed in this letter reflect the views of certain partners of this law firm who participated in the preparation of this letter. Our letter does not necessarily reflect the views of all attorneys in the firm or any particular client.

Without commenting on the overall merits of the Rule 4.5 Proposal, we provide the comments below. As described below, if the Rule 4.5 Proposal is implemented as proposed, there will be a number of direct material conflicts that commodity mutual fund sponsors will face when attempting to comply with the Part 4 Rules under the Commodity Exchange Act ("CE Act") and the rules and regulations under the Investment Company Act of 1940, as amended (the "1940 Act"). Accordingly, if the CFTC determines to adopt the Rule 4.5 Proposal, the CFTC should consider delaying implementing the changes to Rule 4.5 until such time as the U.S. Securities and

[1] Commodity Pool Operators and Commodity Trading Advisors, 76 Fed. Reg. 7976 (proposed Feb 11, 2011).

Exchange Commission ("SEC") and CFTC have had an opportunity to harmonize applicable CFTC and SEC rules and adopt appropriate relief from such rules.[2]

Marketing Restrictions

One of the proposed revisions to Rule 4.5 would require registered investment companies ("mutual funds") relying on Rule 4.5 to represent that they "will not be, and [have] not been, marketing participations to the public as or in a commodity pool or otherwise as or in a vehicle for trading in (***or otherwise seeking investment exposure to***) the commodity futures or commodity options markets"[3] (the "Marketing Restriction"). If the Rule 4.5 Proposal is adopted as proposed, the provision "or otherwise seeking investment exposure to" introduces an ambiguity that merits immediate clarification in light of the sophisticated nature of modern day investment products that, loosely speaking, have "futures exposure." The following identify a number of such ambiguities:

- Would eligible mutual funds be precluded from trading structured notes, exchange-traded funds or exchange-traded notes that have exposure to commodity futures or options on commodity futures?

- Would a mutual fund be precluded from allocating a portion of its assets to a foreign subsidiary that trades *de minimis* amounts of futures?

- Further, to what extent, if any, would this language preclude utilization of the proposed "bona fide hedging exemption" and participation in the "5% limitation?"[4]

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[2] The National Futures Association noted the following in its comment letter to the CFTC regarding the Rule 4.5 Proposal dated October 18, 2010: "Therefore, NFA not only encourages the Commission to provide adequate time for [the mutual funds] to comply with the Commission's applicable regulations if certain operating restrictions are adopted but more importantly [to] consider as part of any proposed rulemaking what, if any, relief may be appropriate for [commodity pool operators] offering [mutual funds] as pools subject to the CFTC's jurisdiction."

[3] 75 Fed. Reg. 56997, 56998 (proposed Sept. 17, 2010) (emphasis added).

[4] The Rule 4.5 Proposal would also require persons claiming a 4.5 exclusion to represent that they: "(a) [w]ill use commodity futures or commodity options contracts solely for bona fide hedging purposes within the meaning and intent of [Rule] 1.3(z)(1)" (the "bona fide hedging exemption") and further to provide that "with respect to positions in commodity futures or commodity options contracts that may be held by a qualifying entity only which do not come within the meaning and intent of [Rule] 1.3(z)(1), a qualifying entity may represent that the aggregate initial margin and premiums required to establish such positions will not exceed five percent of the liquidation value of the qualifying entity's portfolio, after taking into account unrealized profits and unrealized losses on any such contracts it has entered into; and, [p]rovided further, [t]hat in the case of an option that is in-the-money at the time of purchase, the in-the-money amount as defined in [Rule] 190.01(x) may be excluded in computing such [five] percent." (the "5% limitation")

- Would the disclosures required under the 1940 Act and the rules and regulations thereunder relating to the description of an eligible mutual fund's investment strategy constitute "marketing?"

Due to the ambiguities in the proposed language, the CFTC should consider removing the language "or otherwise seeking investment exposure to" from the Marketing Restriction. In addition we request that the CFTC clarify in the Rule 4.5 Proposal what constitutes "marketing" under Rule 4.5.

Substantive Disclosure and Operating Requirements

As described below, if the Rule 4.5 Proposal is implemented as proposed, there will be a number of direct material conflicts that commodity mutual fund sponsors will face when attempting to comply with the Part 4 Rules under the CE Act and the rules and regulations under the 1940 Act. As we believe the conflicts presented would be so great as to limit market participants from offering a commodity mutual fund, we would urge the CFTC to delay the implementation of the Rule 4.5 Proposal until such time as the SEC and CFTC have harmonized their respective rules or provide appropriate relief for commodity mutual funds from such conflicting provisions.[5] In the interim, registered mutual funds that have relied on, or entities seeking to rely on, the Rule 4.5 exclusion from the definition of commodity pool operator should be permitted to continue offering their securities, or register as investment companies and offer their securities, as currently permitted. Once the SEC and CFTC have harmonized their rules, a reasonable period of time should be provided to existing commodity mutual funds so as to afford them the opportunity to comply with any newly adopted rules.

Below, we outline the most significant of such conflicts along with proposed solutions.

Performance Information

One of the most significant conflicts between the disclosure requirements contained in Part 4 of the CFTC's rules and the 1940 Act and the rules and regulations thereunder relates to the disclosure of performance information. Specifically, if the offered pool has less than three years of performance history, CFTC Rule 4.25(c)(2) requires an offering document to include (i) performance information of all pools and accounts operated by the commodity pool operator other than the offered pool and (ii) performance history of major commodity trading advisors to the offered pool.[6] On the

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[5] This, of course, assumes that a mutual fund is in compliance with its obligations under the 1940 Act.

[6] CFTC Rule 4.25 requires the following information, among other information: the date of inception of trading, the aggregate gross capital subscriptions to the pool, the pool's current net asset value, the largest monthly draw-down during the most recent five calendar years and year-to-date, the worst peak-to-valley draw-down during the most recent five calendar years and year-to-date. If the offered pool has more than three years of performance history it is only required to show the offered pool's performance information.

other hand, the SEC generally views the inclusion in a mutual fund's prospectus of an adviser's performance information for unrelated accounts as misleading under Section 34(b) of the 1940 Act and therefore including such performance information is prohibited.[7] Additionally, the fee table required by Item 3 of the SEC's Forms N-1A and N-2 is largely irreconcilable with CFTC Rule 4.24(d)(5), which requires the inclusion of a break-even table.

It would not be possible to reconcile the differences described above without amending existing SEC and/or CFTC rules. Accordingly, we suggest two possible solutions: (1) requiring commodity mutual funds to comply with both regimes, presenting information in two different sections of the offering document[8] or (2) only requiring disclosure of performance information for the existing pool and requiring advisers to disclose related account performance.

Offering Document Delivery Requirement

SEC and CFTC rules conflict with respect to the delivery and timing of offering documents. For instance, CFTC Rule 4.21 requires delivery of a disclosure document to a prospective investor prepared in accordance with CFTC Rules 4.24 and 4.25 before the investor executes a subscription agreement. Moreover, the investor must also sign and date an acknowledgement of the receipt of the disclosure document before the investor's subscription is accepted. Compliance with CFTC and SEC offering document delivery requirements would interfere with the well-established process followed by mutual funds as permitted under the 1940 Act.[9] The CFTC has proposed relief for exchange-traded funds ("ETFs") from CFTC Rule 4.21 that would permit ETFs to deliver offering documents by making the document accessible on an Internet website maintained by the sponsor. The sponsor must also comply with CFTC Rule 4.26 (regarding updating the offering document as necessary) and must inform fund participants that the document is available via the Internet.[10]

Item 4(b)(2) of Form N-1A requires the following performance information with respect to a mutual fund: bar chart showing a fund's annual returns for each of the last ten years (or inception if shorter), a fund's average return during the ten years covered, average annual total returns for one, five and ten calendar year periods, a fund's highest and lowest return for a quarter during the 10 years or other period of the bar chart, returns of an appropriate broad-based securities market index and a brief explanation of the calculation of after-tax returns.

[7] *See* Growth Stock Outlook Trust, Inc. (pub. avail. Apr. 15, 1986)(SEC permitted a fund to disclose the prior performance of the adviser's similarly managed private accounts provided, among other conditions, that the adviser include all comparable like-managed private accounts, and only like-managed private accounts). *See also* Nicholas-Applegate Mutual Funds (pub. avail. Feb. 7, 1997).

[8] The CFTC required disclosure could, for instance, be provided in a separate CFTC section in the statement of additional information.

[9] The SEC delivery requirement is that a prospectus must be delivered at or before the time of sale but the requirement may be satisfied by delivery of the prospectus with the confirmation.

[10] *See* 75 Fed. Reg. 54794 (proposed Sept. 9, 2010) entitled "Commodity Pool Operators: Relief from Compliance with Certain Disclosure, Reporting and Recordkeeping Requirements for Registered CPOs of

We propose similar relief be granted to commodity mutual funds from CFTC Rule 4.21 to the extent that the offering document is made available on a website maintained by the sponsor and the availability of the offering document on such website is disclosed to potential investors.

Miscellaneous Rules/Regulations

We have listed below certain other CFTC rules and corresponding SEC rules that we believe would be in conflict if a commodity mutual fund were required to comply with both disclosure regimes.[11] To the extent such rules are in conflict and the SEC and CFTC each determine that a commodity mutual fund must comply with both sets of rules, we would suggest a separate CFTC section be included in the mutual fund's statement of additional information.[12]

CFTC/SEC Rule	CFTC Requirement	SEC Requirement	Proposal
4.24(a) and (b) / Item 1, Rule 481(b)	Mandatory legends / cautionary statement.	Mandatory legends.	Revise Form N-1A so CFTC legends can be provided on page following cover.
Rule 4.24(i)(1) & (2) / Item 3	Description of all fees and expenses.	Fee and expense table; SEC rules require a very particular format.	Provide SEC required table with detailed footnote disclosure.
Rule 4.24(u) / Form N1-A	CPO must provide monthly/quarterly reports and annual audited reports.	No fund duty to provide account statements (is an obligation of the broker); annual and semi-annual reports are	Provide relief from CFTC account statement reporting requirement.

Commodity Pools Listed for Trading on a National Securities Exchange; CPO Registration Exemption for Certain Independent Directors or Trustees of These Commodity Pools." Currently, a significant number of ETFs operate with an exemption from CFTC Rule 4.21 by virtue of No-Action letters issued by the Staff of the CFTC.

[11] We have only included reference to Form N-1A as we understand the vast number of commodity mutual funds to be open-ended funds.

[12] We note that the organizational format of offering documents under CFTC and SEC rules are vastly different. Under SEC rules, only Part A of the prospectus is required to be delivered to investors. For this reason, to the extent CFTC disclosures are required we recommend that the SEC amend Form N-1A to provide for a CFTC section in the statement of additional information that would contain all CFTC required disclosures.

		required to be sent to investors.	
Rule 4.26(a)(2) / Form N1-A	Must update disclosure document every 9 months.	Annual update required.	Eliminate CFTC 9-month requirement and reconcile with SEC annual requirement.

Conclusion

If the CFTC determines to adopt the Rule 4.5 Proposal (or some form of the Rule 4.5 Proposal), we would encourage the CFTC to adopt an appropriate timetable for implementation. Given the complexity and incompatibility of the two disclosure regimes and the fact that a commodity mutual fund sponsor would be working with two different regulators, we would expect the preparation of revised offering documents to take a significant amount of time. As such, we suggest the following:

- The Rule 4.5 Proposal should have a delayed implementation date in order to provide the SEC and CFTC with time to reconcile the two disclosure regimes;
- Currently offered commodity mutual funds should not be prohibited from operating during the transition period and should be afforded a reasonable amount of time to comply with any joint rules issued by the SEC and CFTC to reconcile the ability to comply with both sets of rules; and
- New commodity funds seeking registration should be permitted to register as investment companies as the SEC and CFTC seek to harmonize their respective rules.

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We appreciate the opportunity to submit this letter and we hope that the comments expressed herein are helpful to the Commission in connection with the important rule-making contemplated by the Release. If you have any questions, please contact David J. Baum (202.239.3346), Matthew W. Mamak (212.210.1256) or Timothy P. Selby (212.210.9494).

Respectfully submitted,

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