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April 12, 2011

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

Re: Request for Comment on Proposed Rules Under the Commodity Exchange Act proposing to amend existing regulations and proposing one new regulation regarding Commodity Pool Operators and Commodity Trading Advisors; Proposed Rule 76 FR 7976

Dear Mr. Stawick:

We submit this letter in response to the request of the Commodity Futures Trading Commission (the "Commission") in Proposed Rule 76 FR 7976 (the "Proposal") for comment on, among other proposals: (i) the proposed rescission of the exemptions from registration as a Commodity Pool Operator (a "CPO") provided in §§ 4.13(a)(3) and 4.13(a)(4) of the Commission's regulations; (ii) the proposed modification of the criteria for claiming relief under § 4.5 of the Commission's regulations; and (iii) new data collection for CPOs and Commodity Trading Advisors ("CTAs").[1] Please also see our letter to the Commission and the Securities and Exchange Commission (the "SEC") regarding proposed Rule 204(b)-1 and Form PF under the Investment Advisers Act of 1940 (the "Advisers Act").

Seward & Kissel LLP has a substantial number of clients who would be affected by the adoption of the Proposal. We respectfully submit the following comments and request that the Commission consider them before adopting the Proposal.

I. Rescission of §§ 4.13(a)(3) and 4.13(a)(4)

The Commission proposes to rescind the exemptions from registration as a CPO provided in §§ 4.13(a)(3) and 4.13(a)(4) of the Commission's regulations.[2] § 4.13(a)(3) of the Commission's regulations currently provides that a person is exempt from registration as a CPO if the interests in the pool are exempt from registration under the Securities Act of 1933 (the "Securities Act") and offered only to Qualified Eligible Persons ("QEPs"), accredited investors, or knowledgeable employees, and the pool's aggregate initial margin and either the premiums

[1] Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 76 Fed. Reg. 7976 (proposed Feb. 11, 2011) (to be codified at 17 C.F.R. pts. 4, 145, and 147).
[2] *Id.*

attributable to commodity interests do not exceed five percent of the liquidation value of the pool's portfolio or the aggregate net notional value of commodity interests does not exceed 100 percent of the liquidation value of the pool's portfolio.[3] § 4.13(a)(4) of the Commission's regulations provides that a person is exempt from registration as a CPO if the interests in the pool are exempt from registration under the Securities Act and the operator reasonably believes that the participants are all QEPs.[4]

A. Lack of Sufficient Justification for Rescission

The Proposal states that as a result of these exemptions, a large group of market participants have fallen outside of the oversight of regulators and that there is very little, if any, transparency or accountability over the activities of these participants.[5] As discussed below, many of these market participants will be required to register with the SEC under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). By registering with the SEC, these investment advisers will be sufficiently regulated and additional oversight by the Commission is unnecessary.

We believe that rescinding §§ 4.13(a)(3) and 4.13(a)(4) is not reasonably related to the Commission's goal of increasing transparency and accountability, especially in light of the government's mandate to avoid regulations that are not worth the cost.[6] The Commission cites the passage of the Dodd-Frank Act and the change in the regulatory environment as a justification for the rescission of §§ 4.13(a)(3) and 4.13(a)(4).[7] However, the Dodd-Frank Act, while making numerous amendments to the Commodity Exchange Act that effect CPOs and CTAs, did not mandate or even suggest that the Commission rescind §§ 4.13(a)(3) and 4.13(a)(4).[8] As a result, we do not believe that the Commission has provided adequate justification for the rescission of §§ 4.13(a)(3) and 4.13(a)(4).

B. Comparability with SEC Investment Adviser Registration Exemptions under the Dodd-Frank Act

The Proposal states "the Commission does not want its registration and reporting regime for pooled investment vehicles and their operators and/or advisors to be incongruent with the registration and reporting regimes of other regulators, such as that of the SEC for investment advisers under the Dodd-Frank Act."[9] In fact, the Commission states in the Proposal that "[m]any private funds claim an exemption from SEC registration under sections 3(c)(1) and (7) of the Investment Company Act of 1940 (the "Investment Company Act"). The Dodd-Frank Act, although not rescinding these exemptions from registration under the Investment Company

[3] *Id.* at 7985.
[4] *Id.*
[5] *Id.*
[6] *See* Barack Obama, Opinion, *Toward a 21st-Century Regulatory System*, WALL ST. J., Jan. 18, 2011, at A17 (stating that regulations that are not worth the costs should be rooted out).
[7] Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 76 Fed. Reg. at 7977.
[8] *Id.* at 7985-86.
[9] *Id.* at 7978.

Act, requires the advisers of such funds to register with the SEC as 'private fund investment advisers'. The Commission's proposal seeks to eliminate the exemptions under §§ 4.13(a)(3) and (4) for operators of pools that are similarly situated to private funds that previously relied on the exemptions under §§ 3(c)(1) and (7) of the Investment Company Act and § 203(b)(3) of the Investment Advisers Act."[10]

While the Commission understandably wishes to align its regulatory regime, with the regime put into place by the Dodd-Frank Act, as described below, the proposed rescission would not achieve this goal but would create the incongruent registration and reporting regime the Commission has stated it wishes to avoid.

The Dodd-Frank Act created a robust regulatory framework for the financial industry that, among other things, increased the number of investment advisers that will be required to register with the SEC. From this new larger group, the Dodd-Frank Act created (i) a new category of "mid-sized advisers" that will be prohibited from registering with the SEC and will be regulated by state securities authorities, (ii) a "private fund adviser exemption" from registration as an investment adviser for advisers solely to private funds with less than $150 million in assets under management, (iii) a "venture capital adviser exemption" from registration as an investment adviser for advisers solely to venture capital funds, and (iv) a "foreign adviser exemption" from registration as an investment adviser for advisers that (a) have no place of business in the United States; (b) have, in total, fewer than 15 clients in the U.S. and investors in the U.S. in private funds advised by it; (c) have less than $25 million in aggregate in assets under management attributable to such clients and investors; and (d) do not hold themselves out generally to the public in the U.S. as investment advisers. In addition, (i) under § 202(a)(11) of the Advisers Act a family office is excluded from the definition of investment adviser; and (ii) under Rule 203A-1 promulgated under the Advisers Act, investment advisers with assets under management of less than $25 million are generally prohibited from registering with the SEC. The proposed rescission of §§ 4.13(a)(3) and 4.13(a)(4) would potentially subject all of these entities to registration with the Commission, regardless of the level of trading in commodity interests.

We recommend that if the Commission rescinds §§ 4.13(a)(3) and 4.13(a)(4) as proposed, it should provide alternative comparable exemptions, exclusions and prohibitions from registration for CTAs and CPOs. We particularly believe this to be the case because the proposed rescission will have the inequitable result of requiring many investment advisers that primarily invest in securities and not futures to register with the Commission but not the SEC.

C. Equal Treatment for CTAs and CPOs

In addition, § 203(b)(6)(a) of the Advisers Act, as amended by the Dodd-Frank Act, provides that an investment adviser generally does not have to register with the SEC if such adviser is registered with the Commission as a CTA and such adviser's business does not consist primarily of acting as an investment adviser. § 203(b)(6)(b) of the Advisers Act, as added by the

[10] *Id.* at 7985-86.

Dodd-Frank Act, provides that an investment adviser does not have to register with the SEC if such adviser advises a private fund and the business of the adviser is not predominantly the provision of securities-related advice. We note that § 4m(3) of the Commodity Exchange Act excludes advisers from registration as a CTA if the adviser is registered with SEC and does not act as a CTA to any commodity pool engaged primarily in trading commodity interests. However, we recommend that the Commission enact regulations reciprocal to § 203(b)(6)(b) that exempt an investment adviser registered with the SEC from registration as a CPO if such adviser's business does not consist primarily of acting as a CPO or if such adviser advises a private fund and the business of the adviser is not predominantly the provision of commodities-related advice. The duplicative oversight and monitoring by the Commission and the SEC that would be created by the dual registrations is the sort of unnecessary expense that should be avoided, particularly in the light of the already increased expenses and the government's express mandate of enforcing the mandatory requirements of the Dodd-Frank Act.[11]

D. If the Commission Rescinds §§ 4.13(a)(3) and 4.13(a)(4), We Recommend An Alternative De Minimis Standard

Investing with commodity instruments is a valuable tool used by many private investment funds to hedge other investments. Faced with the costs and burdens of registration as a commodity pool operator in order to trade in a de minimis amount of commodity instruments, many investment advisers may opt to use alternative methods of hedging that that are less effective and more expensive than trading in futures, thereby eliminating trading in commodity instruments, to the potential detriment of underlying investors. Accordingly, we recommend that even if the Commission decides to rescind § 4.13(a)(4) of the Commission's regulations, § 4.13(a)(3) or some other form of de minimis exemption should remain in effect. The Commission stated in the Proposal that it believes that it is possible for a pool to have a portfolio that is sizeable enough that the pool can comply with the de minimis exemption of § 4.13(a)(3) and still constitute a major participant in the futures market.[12] It is highly unlikely that such a pool would not be subject to SEC regulation rendering duplicative monitoring by the Commission unnecessary.

E. Grandfathering Provision

The Commission asks in the Proposal if entities that have previously claimed exemption under §§ 4.13(a)(3) and 4.13(a)(4) should be exempted from compliance with the rescission of such exemptions.[13] Many investment advisers are currently operating private investment funds that trade in commodity interests in reliance on § 4.13(a)(3) or § 4.13(a)(4). It would be extremely burdensome for such advisers to now have to register as a CPO or, as described above, alter their investment program to remove investments in commodity interests.

[11] *See* Jean Eaglesham and Victoria McGrane, *A CFTC Budget Fight Stops Work on Alarm*, WALL ST. J., Feb. 25, 2011, at C1, C2 (discussing how the Commission's budget prevents it from effectively enforcing the mandatory provisions of the Dodd-Frank Act).

[12] Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 76 Fed. Reg. at 7985.

[13] *Id.* at 7984.

Accordingly, we recommend that any entity that has previously claimed an exemption under § 4.13(a)(3) or § 4.13(a)(4) be allowed to continue to rely on such exemption.

II. Modification of § 4.5

The proposed amendments to § 4.5, which excludes registered investment companies ("RICs") from the definition of CPOs, would reinstate the restrictions on the exclusion that were in effect prior to 2003. The Proposal responds to concerns, represented in, among other things, a rulemaking petition submitted by the National Futures Association ("NFA"), that certain RICs are offering series of "de facto" commodity pools under the exclusion provided by Rule 4.5.[14]

Prior to 2003, a RIC could claim the exclusion provided by § 4.5 if it used futures and options for bona fide hedging purposes and its aggregate initial margin and premiums did not exceed 5% of the liquidation value of the RIC's portfolio. In addition, the RIC could not be marketed as a vehicle for trading in the futures or options market. The Commission eliminated these restrictions in 2003 because RICs were subject to the requirements of the Investment Company Act and regulated by the SEC, which served to provide adequate customer protection.

The Commission stated that it believed that it was necessary to reinstate the restrictions to halt the practice of RICs offering futures-only investments without the Commission's oversight and engaging in regulatory arbitrage.[15] The reinstatement of these restrictions on the exclusion from registration would severely limit RICs trading in futures and options, which has expanded in recent years. RICs are very dissimilar to CPOs, with different operations, fee structures, and investment and leverage restrictions. They are currently subject to extensive regulation and it would be difficult and costly to comply with the requirements applicable to CPOs. The Commission and the NFA petition cited only a few examples of alleged futures-only RICs[16] and it appears to be a very broad and burdensome response to reinstate the restrictions for all RICs. For these reasons, we do not believe that § 4.5 should be amended.

III. Data Collection in Connection with Assessment of Systemic Risk

The Proposal states that it is the Commission's view that the operators of pools that are similarly situated to private funds that rely on §§ 3(c)(1) or 3(c)(7) of the Investment Company Act should be subject to similar regulatory obligations as the advisers of such private funds, including proposed Form CPO-PQR.[17] We agree that reporting should be consistent as between the Commission and the SEC, and recommend the reduction of repetitive reporting to reduce the reporting burden of investment advisers that act as both CTA and CPO or who are dually registered with the Commission and SEC.

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[14] *Id.* at 7983-84.
[15] *Id.* at 7984.
[16] Letter from Thomas W. Sexton, III Thomas W. Sexton, III, Senior Vice President and General Counsel of the National Futures Association, to David Stawick, Office of the Secretariat, Commodity Futures Trading Commission (June 29, 2010), *available at* http://www.nfa.futures.org/news/newsPetition.asp?ArticleID=2491.
[17] *Id.* at 7985-86.

A. Exemptions from Reporting

§ 404 of The Dodd-Frank Act specifies that SEC registered investment advisers may be required to provide information for the assessment of systemic risk.[18] Because the statutory framework of the Dodd-Frank Act does not contemplate the provision of information for risk assessment purposes by investment advisers exempt, excluded or prohibited from SEC registration, we believe such investment advisers are presumed to be an inappropriate focus for the assessment of systemic risk.

As such, we recommend that the Commission enact regulations that provide comparable exemptions from the requirement to file such forms for all investment advisers exempt from registration with the SEC because requiring these entities to provide the information on Form CPO-PQR and CTA-PR is outside of the spirit, if not mandate of the Dodd-Frank Act. We note that if §§ 4.13(a)(3) and 4.13(a)(4) are rescinded as proposed, the inequitable result will be risk reporting to the Commission by investment advisers that primarily trade in securities and not commodity interests.

B. Elimination of Repetitive Reporting

CPO/CTA Forms Overlap. To eliminate the burden of duplicative filings, we recommend that Forms CTA-PR and CPO-PQR be revised to eliminate duplicative reporting. For example, dually-registered CPOs and CTAs should not be required to disclose identical information in connection with a particular pool on both forms. In this regard, we recommend that the instructions for Form CPO-PQR and CTA-PR address the potential for duplicative reporting of information on CTA-PR and CPO-PQR and clarify how CPOs and CTAs should complete the respective forms in cases where information reported with respect to a particular pool may come from multiple sources.

SEC/Commission Forms Overlap. Under the current proposals, dually-registered investment advisers will be required to file Form PF with the SEC and file portions of Form CPO-PQR and/or CTA-PR with the Commission. These forms overlap in certain areas. In light of the fact that the information reported by both the SEC and the Commission will be directed to the Financial Stability Oversight Council, we recommend that the SEC and the Commission work together to eliminate repetitive reporting items and to share information that is sought by both agencies and revise the forms for dually-registered investment advisers to reflect this. The key areas of overlap amongst the forms include disclosures regarding assets under management, performance and schedules of investments.

Reporting Divergence. To be consistent with the articulated goal of soliciting "information that is generally identical to that sought through Form PF,"[19] the Commission should conform Forms CPO-PQR and CTA-PR to the proposed Form PF. (Please also see Part

[18] *Id.* at 7977.
[19] *Id.* at 7978.

III.C. – Significant Burdens, for additional recommendations to the forms related to the significant burdens posed by the completion of the forms and filing frequency.) The key differences between Form PF and Forms CPO-PQR and CTA-PR are:

(1) Timeline. As shown in the charts listed in the Proposal, a single investment adviser entity may be subject to different reporting timelines in connection with its reporting requirements with the SEC and the Commission. For example, a dually-registered CPO and investment adviser with assets under management of less than $1 billion will be required to file Form PF with the SEC annually and Form CPO-PQR with the Commission quarterly. The Commission has provided little justification for its more frequent reporting regime for such investment adviser. We recommend that the Commission and the SEC harmonize the reporting timelines to reduce the reporting burden to which dually registered applicants will be subject.

(2) Mid-Sized Entities. Form PF creates two thresholds for reporting requirements: small advisers (which manage less than $1 billion in hedge fund assets under management) and large advisers (which manage more than $1 billion in hedge fund assets under management). The Proposal creates three thresholds for staggered reporting on Form CPO-PQR, small CPOs (which manage less than $150 million in pool assets under management), mid-sized CPOs (which manage more than $150 million but less than $1 billion in pool assets under management) and large CPOs (which manage more than $1 billion in pool assets under management). We recommend that the Commission eliminate the mid-sized CPO category in order to harmonize reporting between the Commission and the SEC. In addition, the Proposal creates two thresholds for reporting on Form CTA-PR: small CTAs (which direct less than $150 million of pool assets) and large CTAs (which direct more than $150 million of pool assets). We recommend that the threshold for a large CTA be raised to match that of large CPOs and large advisers.

(3) Information Divergence. Despite the articulated intention by the Commission to create consistent reporting for registered CPOs, CTAs and investment advisers, under the current proposals, the disclosures required by Forms CPO-PQR, CTA-PR and PF inexplicably diverge in certain areas. We recommend that the SEC and the Commission work together to create harmonious forms, which would allow for easier reporting, reviewing and monitoring. The key inconsistencies amongst the forms include Form CPO-PQR's required disclosure of: foreign regulatory authorities that currently monitor the CPO's pools, pool service providers, pool subscriptions and redemptions and an analysis of pool participant's investment status with regards to the any high water mark provisions.

C. Significant Burdens

Minimum Thresholds. Due to the significant burden imposed by Forms CPO-PQR and CTA-PR, registration as a CPO or a CTA should not be the sole factor used to determine whether an entity is required to file Forms CPO-PQR and/or CTA-PR. We recommend that the Commission should establish a minimum threshold for filing Forms CPO-PQR and CTA-PR. We believe that setting a minimum threshold for reporting is still in-line with the goal of monitoring systemic risk, yet it strikes a more realistic balance between the cost

and benefit of such a reporting system. We further recommend that the threshold for determining a "Large CPO" and a "Large CTA" be increased to at least $5 billion. The $5 billion threshold will give U.S. regulators sufficient information to monitor systemic risk without imposing a significant burden on smaller entities that do not pose a systemic risk.

Calculation and Filing Frequencies. Under the Proposal, the thresholds for "Large CPO," "Mid-Sized CPO" and "Large Pool" all must be measured as of the close of business every day.[20] To assess whether a CPO or pool exceeds the thresholds, the CPO would be required to calculate and monitor their pool assets under management on a daily basis. Requiring daily calculations of a CPO's assets under management is burdensome. Many CPOs manage funds-of-funds which invest in underlying private funds that do not distribute their net asset value to investors on a daily basis. We recommend that the Commission reevaluate the proposed daily calculation requirement and adjust it to an end of month calculation. This would be more aligned with the current practices of most CPOs.

The Commission asks for comment on the proposed filing frequency of Forms CPO-PQR and CTA-PR.[21] Under the Proposal, Forms CPO-PQR and CTA-PR generally must be filed within 15 days of the end of each quarter.[22] We believe that the proposed filing frequency is not feasible because a significant portion of the information required on Forms CPO-PQR and CTA-PR is not easily obtained in such a short period of time.

NFA Compliance Rule 2-46 currently requires quarterly reporting for CPOs within 45 days after the end of each quarter. The information requested in Form CPO-PQR is much more extensive than that required by NFA Compliance Rule 2-46. In addition, we believe that the Commission's burden estimate of 30 hours for a Large CPO is severely understated. Accordingly, in line with the recommendation we made in our comment letter to the Commission and the SEC regarding proposed Rule 204(b)-1 and Form PF, we suggest that CPOs and CTAs be given at least 120 days to prepare and file Forms CPO-PQR and CTA-PR.

D. Confidentiality

Proposed Forms CPO-PQR and CTA-PR will require disclosure of significant amounts of proprietary and highly sensitive material, which, if made publicly available, would compromise CPOs, CTAs and their clients.

While the Commission has disclosed how it intends to keep such information confidential, we recommend as an additional protection that the Commission assign CPOs and CTAs and the entities they advise anonymous identifiers which will be used when completing Forms CPO-PQR and CTA-PR. Such identifiers will have no direct link to the CPO or CTA, and as such, will prevent the linking of a CPO or CTA with a Form CPO-PQR or CTA-PR, respectively, should such form be released to the public. The Commission and the SEC may maintain a secure database which would link the alphanumeric identifiers to the CPOs and CTAs

[20] Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 76 Fed. Reg. at 7981.
[21] *Id.* at 7979.
[22] *Id.*

and the entities they advise. This would provide an added layer of protection for many CPOs and CTAs for which the information submitted on such forms constitutes confidential proprietary information.

We appreciate the opportunity to comment on the Proposal. If you have any questions regarding this letter, please contact the undersigned.

Very truly yours,

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and

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