MANAGED FUNDS ASSOCIATION

VIA ELECTRONIC MAIL: PUBCOM@NASD.COM

March 12, 2004

Ms. Barbara Z. Sweeney
Senior Vice President and Corporate Secretary
NASD
1735 K Street, NW
Washington, DC 20006-1500

Re: NASD Notice to Members 04-07: Policy on Trail Commissions in Publicly Offered Commodity Pools

Dear Ms. Sweeney:

MFA welcomes the opportunity to comment upon the NASD's proposal to rescind its long-standing policy with respect to compensation paid to CFTC-regulated brokers who place interests in a publicly offered commodity pool and provide ongoing services to investors in the pool ("trail commissions"). Under that policy, trail commissions have not been deemed to be sales compensation, subject to the limitations in NASD Rule 2810, for over 20 years. As demonstrated in this letter, MFA believes that the NASD's policy should be codified rather than rescinded in order to permit the continued efficient operation of commodity pools, including provision of important services to commodity pool investors.

MFA is the only US-based membership organization dedicated to serving the needs of professionals who manage managed futures funds, hedge funds, and fund of funds. Our over 700 members manage a significant portion of the estimated $750 billion invested in these alternative investment vehicles. Among the MFA membership are commodity pool operators (CPOs), commodity trading advisors (CTAs), as well as NASD-member broker-dealers, who represent a significant portion of the estimated $87 billion invested in managed futures products, including publicly offered commodity pools. Accordingly, MFA's members have a keen interest in the proposals set forth in NASD's Notice to Members 04-07.

What are Commodity Pools? For purposes of this letter, commodity pools are publicly offered collective investment vehicles that trade in futures contracts and options on futures contracts ("futures"). Some also trade in spot and forward foreign currencies. Commodity pools do not trade in securities, although some may maintain cash balances in Treasury bills or other cash equivalents. Commodity pools are not investment companies as defined under the

Investment Company Act of 1940. Recent industry estimates indicate that there are about 55 public pools in the United States aggregating approximately $9 billion.[1]

Trading in futures is subject to the jurisdiction of the Commodity Futures Trading Commission ("CFTC") under the Commodity Exchange Act ("CEA"). The CFTC under the CEA also regulates the professionals involved in futures, including commodity pool operators ("CPOs"), commodity trading advisors ("CTAs") and futures commission merchants ("FCMs"). Each commodity pool has one or more CPOs, CTAs and FCMs. The CPO of a pool in the form of a limited partnership is its general partner. The CTA may be the CPO or one or more unaffiliated persons who provide trading advice to the pool with respect to futures. The FCM is the commodity broker that carries the commodities account(s) of the pool. The FCM may execute and clear all trades for the pool or trades may be executed by other firms and "given-up" to the FCM for clearing. Each of the CPOs, CTAs and FCMs for commodity pools is registered with the CFTC and is a member of NFA, the futures self-regulatory organization. Each is subject to the rules of the CFTC and the NFA.

Commodity pools pay management and incentive fees to their CTAs for commodity trading advice and brokerage commissions to their FCMs for commodity brokerage services. Some pools also pay administrative fees to their CPOs. Trail commissions are typically portions of the commodity brokerage commissions paid by the pool. Such commissions may be charged as a flat percentage of assets on a monthly basis or as round-turn commissions for each futures trade. In some pools trail commissions may be portions of the management or administrative fees paid by the pool. We know of no pool in which trail commissions are a separate charge to the pool or a charge deducted from an investor's subscription amount as suggested in the Notice to Members. In all cases, trail commissions are payments for ongoing services provided to the pool and its investors. Trail commissions are not selling commissions deducted from an investor's subscription amount and paid to a selling agent.

It should be noted that the prospectus and offering materials for commodity pools are reviewed by the Securities and Exchange Commission ("SEC"), the NASD, the CFTC/NFA and many of the states. All of the fees payable by commodity pools, including those from which trail commissions are paid and the level of trail commissions paid, are required to be disclosed in the prospectus. The facts that trail commissions will be paid, the amount of the trails and the conflicts of interest related to payment of trails are disclosed, along with a description of the services provided. In addition, since trails are paid from other forms of compensation, which are themselves limited in amount by the NASAA Commodity Pool Guidelines, trails are indirectly regulated.

In over twenty years of history, publicly offered commodity pools have had no history of abuses; and, more specifically, there is no history of abuses connected with the

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[1] *See MAR/Hedge Report* (February 2004), *Stark Trader Analysis Report* (February 2004) for public commodity pool industry statistics as of January 31, 2004.

payment of trail commissions. In addition, over this period, advisory and brokerage fees paid by public commodity pools have been substantially reduced, presumably as the result of competition. While it is not possible to foresee the consequences of rescission of the NASD's trail policy on future offerings of public commodity pools, it is likely that the result would be a decrease in the number of pools offered to the public. Reduction in the number of publicly offered pools could lead to reduced competition and more rigid pricing.

Benefits of Commodity Pools. Commodity pools are generally acknowledged by regulators and the financial press as offering the safest and least expensive mechanism for retail investors to engage in futures trading for investment and/or portfolio diversification purposes through the inclusion of a non-correlated investment to a traditional stock and bond portfolio: pools offer daily net asset valuation, liquidity in the form of monthly (or, more recently, even daily) redemption rights, and professional trading and fund management. These pools are highly regulated and provide limited liability for investors, as well as containing higher suitability standards and solicitation restrictions than other commodity-related investments. For example, individual managed futures accounts are subject to CFTC/NFA regulation, but are not subject to SEC, NASD or state jurisdiction and have unlimited liability, typically higher fees, restricted access to advisors and less regulatory oversight.

Moreover, these commodity pools provide retail investors with access to many of the most successful CTAs. This access would be severely curtailed if commodity pools were not available, due to the large minimum account size requirements of many of those CTAs and the higher suitability requirements and capital obligations of privately offered commodity pools. In addition, portfolio diversification is a basic tenet of modern investment theory. Studies have shown an historical lack of correlation between the performance of managed futures and the performance of the stock and bond components of a traditional investment portfolio. Therefore, pools provide potential diversification from stock and bond portfolios. In fact, most pools offered today are offered as part of a portfolio diversification strategy. If the NASD's policy on trail commissions is rescinded as proposed, and as a result, the number of publicly offered commodity pools is severely reduced, retail investors will be denied access to the only affordable futures-based product currently available in a limited liability structure (i.e., a limited partnership or limited liability company) and to one of the only alternative investment products available to diversify a traditional stock and bond portfolio.

Finally, one of the main functions of futures trading is to provide price discovery with respect to the underlying commodity. In order for futures markets to perform this function, both speculators and hedgers must use the markets. These commodity pools provide a significant source of speculative capital for the United States futures markets that might be curtailed by rescission of the NASD's policy on trail commissions. This could lead to reduced liquidity and volume on U.S. exchanges, and consequently have an adverse effect on the price discovery function performed by those markets.

Justifying Trail Commissions. Trail commissions are service fees paid for commodity-related services. Trail commissions developed from and are consistent with practices of FCMs with respect to individual customer futures accounts. Associated persons of FCMs who service those futures accounts typically share in the commodity brokerage commissions generated by the accounts. Thus, the qualification requirements applicable to recipients of trail commissions are similar to those applicable to associated persons who limit their activities to individual customer futures accounts.

Those who receive trails must qualify to receive them by registering as associated persons under the CEA and must first pass either the Series 3 or the Series 31 examination which requires a demonstrated competency in commodity-related matters. As registrants under the CEA, these individuals are subject to sanctions under the CEA and related rules (including those of the CFTC and NFA). Registrants are also subject to periodic ethics training requirements.

The services provided by associated persons in return for the trails require knowledge of both the product and the commodity markets. The services generally described in the prospectuses of publicly offered commodity pools are: (a) responding to inquiries from investors about the value of units; (b) providing information and responding to inquiries about the futures and forward markets and the fund's trading in those markets; (c) responding to limited partners' inquiries about monthly statements and annual reports and tax information provided to them; (d) providing information to investors about redemption rights and procedures; (d) assisting investors in redeeming units; and (e) providing other services requested from time to time by investors.

As noted above, commodity pools are often offered as part of a portfolio diversification strategy. Consequently, associated persons may be required to monitor the traditional elements of an investor's portfolio as well as the futures component.

If associated persons did not provide these services to pool investors, the pool's CPO would have to incur additional expenses to develop an alternative mechanism for providing such services to pool investors.

Commodity Pools are Different. The regulatory requirements that apply to publicly offered commodity pools exceed considerably those that apply to other limited partnership programs. Those products, such as real estate or oil and gas partnerships, are not subject to a separate federal regulatory framework. Commodity pools and commodity professionals, as noted above, are subject to regulation by the CFTC and NFA under the CEA.

Many states substantively review prospectuses for public pools and impose investor suitability requirements (income and/or net worth - exclusive of home, furnishings and automobiles) on public pool participants. In fact, most states have adopted the NASAA Guidelines for Commodity Pools, which set forth requirements for and limitations on the operation of commodity pools. Limitations include maximum fees to be charged. The current Guidelines specifically permit payment of trail commissions. In contrast, states do not review the prospectuses of registered investment companies and almost anyone can purchase shares in them.

Publicly offered commodity pools also differ from other direct participation programs subject to NASD Rule 2810 in significant structural and operational ways. For example, real estate and oil and gas partnerships typically purchase properties or other assets at the outset of operations and then hold those properties or assets until the termination of the partnership. Although these programs provide annual financial statements, they often do not provide daily net asset values and typically do not permit regular redemptions. Commodity pools, on the other hand, engage in daily trading of multiple futures contracts on multiple markets. Commodity pools are required to provide daily net asset values. Commodity pools provide redemption opportunities on at least a monthly basis. In addition, most commodity pools engage in continuous offerings of interests, at least until such time as a maximum level of assets is reached. As a result of these differences, investors require more and different information than investors in other direct participation programs.

Commodity pools bear certain similarities to closed-end investment companies subject to Rule 2810. These investment companies engage in investments over the life of the fund and may provide redemption opportunities by electing to be treated as an "interval fund." However, investment companies typically have a much lower portfolio turnover rate than commodity pools and often seek to generate long-term capital gains by holding positions for at least a year, whereas commodity pools often engage in short-term trading activity, placing trades on a daily basis. Thus, investors in commodity pools may require information with respect to trading on a daily basis. In addition, the redemption opportunities, if any, afforded by closed-end investment companies are not as frequent as commodity pools. Thus, investors in commodity pools may require information and/or advice from their associated persons in making frequent decisions on whether or not to redeem or purchase more units.

Conclusion. As demonstrated in this letter, trail commissions derive from the futures industry practice with respect to individual futures accounts, are paid out of legitimate and regulated fees paid by commodity pools rather than assessed separately against an investor's subscription amount and are fully disclosed as required by federal and state regulators. In addition, commodity pools and the services provided in return for trail commissions may be distinguished from other direct participation programs. Therefore, MFA believes that the NASD's long-standing policy excluding trail commissions from the limitations in Rule 2810 should be codified rather than rescinded. Such codification will permit the continued efficient operation of publicly offered commodity pools, including provision of important services to commodity pool investors.

We stand ready to meet with you and your colleagues at the NASD to discuss the comments set forth above. I can be reached at 202.367.1140.

Sincerely,

/s/ John G. Gaine
John G. Gaine
President

[*Continued on next page.*]

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