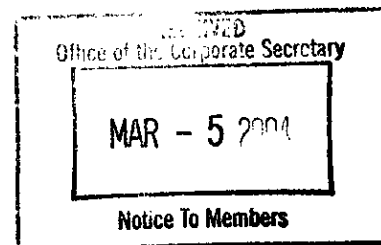




STEBEN & COMPANY, INC.

Managed Futures Since 1989



March 1, 2004

Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street NW
Washington DC 20006-1500

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

To the NASD Corporate Financing Department:

We would like to comment on the proposal by the NASD to limit to 10% the total underwriting compensation, including "trail commissions", for publicly offered commodity pools.

Steben & Company, Inc. ("SCI") is an NASD Member broker dealer and an NFA Member Introducing Broker and Commodity Pool Operator. Commodity pools have been our exclusive business focus since the company was founded in 1989. In addition I have personally been involved with commodity pool offerings for over 21 years.

Commodity pools, both publicly registered and private offerings, are commonly and more appropriately called managed futures funds by investors and most industry participants, (with the exception of regulators and legal counsel).

SCI offers managed futures funds primarily on a wholesale level through over 70 NASD Member broker dealers. In our role as a wholesaler of managed futures funds we have a great deal of experience with the response of brokers and investors to these funds during various market conditions over time.

In our opinion, it is very important for investors that these funds have ongoing compensation to their broker dealer registered representatives. Managed futures funds historically have done quite well overall, based upon the results reflected in the managed futures funds indices. A majority of the money in managed futures funds today is managed by a relatively short list of the better performing, older commodity trading advisors ("CTA's"). As is the case with most growth investments, the investors who fully realized the good results with these trading advisors were those who took a long term approach and who had the discipline to stay with their investment strategy. Unfortunately, when people lack good advice that is based upon a larger perspective, they often make their investment timing decisions based upon an emotional response to short term performance.

Whereas investors have numerous sources of information and reference points to help them in their decisions with traditional mutual funds, there are few, if any, sources available to them for managed futures funds. Managed futures funds have unique characteristics that few people adequately understand, including most professional financial advisors. An ill timed decision to liquidate during a temporary down period, or a failure to liquidate when a fund's management has gone through an undesirable change, can be far more costly to an investor than the ongoing compensation to their financial advisor.

Capping the compensation can cause brokers to succumb to conflicts of interest after the compensation has ended. When investors express fears and unhappiness about short term poor performance there is a strong incentive to move them over to a new investment that offers a new commission.

While we believe strongly that it is in the investors best interest to have ongoing compensation, we don't believe that the current levels of compensation are in the investor's best interest, particularly in today's interest rate environment.

If the compensation in managed futures funds is to be changed, the existing fund compensation arrangements should be grandfathered and not capped. Brokers make their plans and follow a long term business plan based upon the facts available at the time. It would be highly unfair to thousands of brokers and their broker dealers, who in many cases have spent long, hard working years building positions in these funds, (positions which in most cases have been very profitable to their investors), to suddenly take away a very significant portion of their business income because now there is a change in policy. If investors want to move to new, lower cost funds they have monthly liquidity. They are free to move.

To fully understand our position on all of these points, it is important to briefly discuss the potential benefits to investors available through managed futures funds. From there we can discuss what is necessary for investors to fully realize those potential benefits and how this relates to the compensation paid to their financial advisors.

The commodity trading advisors ("CTA's") that we use at SCI have long and very good track records. They use systematic, computer driven trading models which diversify across a broad range of markets. Of course, past performance is not necessarily indicative of future results. Investments in managed futures funds have substantial risk and are suitable only for risk capital. However, the historical track record of these CTA's and the funds that they have managed have demonstrated beyond the shadow of a doubt the benefits potentially available through a long term investment in managed futures funds. Those investors who liquidated their units early on, because of fear during a short term decline, failed to achieve the objective they originally subscribed for. In fact, in many cases they lost money *just due to ill timing*.

The potential benefits available to investors taking a long term approach in managed futures funds are not just long term profits, but more importantly the diversification value of adding an investment category to their portfolio that has had virtually no historical correlation, over longer periods of time, to the stock, bond and real estate markets. Managed futures funds have provided valuable diversification, particularly through periods of sustained bear markets for stocks such as the recent bear market during 2000

to 2003. Managed futures funds have the potential to profit from *declining* markets as well as rising markets, monthly liquidity, transparency (in most cases), a lack of dependency on a rosy economic **scenario**, monthly reporting to investors and diversification into a broad range of **global markets** including currencies, stock indices, interest rates, energy, metals and agricultural commodities. In our experience, most investors can only achieve these potential **benefits** if they have good advice along the way.

There have been many managed futures funds over the years that have experienced significant losses. However, the vast **majority** of the money in managed futures funds today is managed by a relatively small **percentage** of the CTA's who have the longer and better track records.

We would be happy to provide the NASD with historical data as a back up to any of the statements in this letter.

The negative impact to investors of knee **jerk** responses to short term performance is a familiar story. Of course it is also true for **traditional** investments. The very significant difference for managed futures funds is *that few people understand them*, even among professional financial advisors. There is no **real** training in managed futures funds in the College of Financial Planning for those **seeking** the CFP credential. Even those seeking the Certified Financial Analyst ("CFA") **credential** learn about how futures work, but gain no real understanding of managed futures funds or the managed futures fund industry.

In the case of traditional investment categories like stocks, bonds or real estate, (or the mutual funds and REITS that invest in them) there is always a flow of information and discussion in the media as to what is going **on**. Investors in traditional investments have more potential sources of reference to **overcome** their emotional tendency to do the wrong thing. Even so, it has been found in **studies** that investors in mutual funds who use financial advisors tend to experience slightly **better** returns than those who do not rely on professional advice, ("Investors Behaving Badly: An Analysis of Investor Trading Patterns in Mutual Funds & Their Impact on Long-Term Investment Success", Financial Research Corporation, Boston, MA). According to this study, investors taking a "do it yourself" approach redeemed their funds **more** than advisor-assisted investors in every month except one from 1996 to 2000.

While we don't have any formal studies, in **our** experience this tendency to ill timing is *much* more pronounced in managed futures funds. This has several reasons.

First, futures have a reputation for **high risk** among the public, and this makes people more jittery from the start. There are **good reasons** for the association of trading futures with high risk. Studies have found that **as much** as 70% of the people who attempt to trade futures *on their own*, lose money. Sometimes, due to the significant leverage available in futures and due to the **chance of margin calls**, people lose *very badly*, with margin calls causing losses greater than **their original** account deposit.

Trading for one's own account is not the **same** as making an investment in a managed futures fund. In a managed futures fund of the type commonly offered by broker dealers, an experienced manager, (CTA), is making **the** decisions. The manager has a disciplined

approach, including a risk control strategy. The degree of leverage is much less, the diversification is much greater and losses are limited to the investor's investment in the fund. Often there are stop loss points for the fund as whole so that it is unlikely, even in a worst case basis, that an investor would lose their whole investment.

Managed futures funds are engaging in a type of trading activity that is difficult for the typical investor to understand. The fund will be entering into long or short positions in futures or forward contracts. Often the trading includes as many as 20 or even 90 different contracts. These positions can be in markets as different as, for example, the Italian Lira, Natural Gas, the Japanese Government Bond or the Hang Sang index. The investor will not typically understand how the CTA's trading models are interacting or responding to moves in those markets. The performance of the fund will often have little to do with anything the investor is hearing in the general news media.

Often the investor who is concerned about a decline in the NAV discusses the decline with a friend or another financial advisor. Often these people are not educated about this kind of investment. They frequently have gross misconceptions. Other financial advisors without any training may erroneously believe that futures funds are by nature too risky for *any* prudent growth oriented investor. Without a trained advisor that can readily answer questions accurately and provide historical perspective, the investor will often abandon their original investment decision at the worst possible time.

In our experience, managed futures funds involve much more hand holding by the broker than traditional investments. By regulation, brokers and clients receive statements on the investors account and the fund *every month*. To assist the investor properly, brokers need to spend more time learning about how these funds work. On an ongoing basis they need to keep track of how the trading advisors systems are interacting with the various markets being traded. Brokers are willing to do this if they continue to be compensated on an ongoing basis.

You have posed the question of what are the differences between the services provided by Series 31 NFA registered associated persons and registered representatives that are not Series 31 registered. We find that brokers who have taken the Series 31 and registered with the NFA do tend to know more about managed futures funds than those who don't. However, the Series 31 is a lot more about regulatory issues and less about understanding how managed futures funds work. At Steben & Company, we have written a study guide and quiz about managed futures funds that we provide to brokers who do business with us. We have found that the more knowledgeable the broker is, the more likely it is that their investors are making mature and reasoned decisions about their investment. We would be in favor of beefing up the Series 31 with some material covering the basics of how futures contracts work, the mechanics of trading in managed futures funds, the fee structures and other relevant information. The exam need not be anywhere near as comprehensive as the Series 3 commodity broker exam, but to do its job it does need more material than it now has.

If a broker no longer receives any compensation from the fund, and they find that the investor is becoming disgruntled and complains about a decline in their investment, or if the investor becomes a nuisance by asking frequent questions about their monthly statements that require the broker to do research, it is more likely than not that the broker

will come up with an alternative that quiets the investor and results in a new commission. When this happens, it virtually assures that the original objectives of the investment will not be achieved. This is not in the best interest of the investors.

For these reasons we believe that the ongoing compensation in managed futures funds has been warranted and should continue.

However, we would agree that the level of ongoing compensation may be too high. Managed futures funds earn interest income on almost all their assets, usually at the Treasury bill rate. This interest income offsets expenses in the funds. Over the last few years the interest rates have fallen by over 5%. In the light of current interest rates, ongoing trail commissions of 4% per year are, in our opinion, too high and will seriously impact performance over the long term. This will not be good for investors or for our industry.

Industry market competition could eventually bring the levels of trail commissions down as funds with lower expenses tend to outperform the more expensive ones. However there will always be some fund sponsors who will attempt to attract brokers with higher levels of compensation. For short periods these funds could still have high performance with the high expenses, thereby attracting more investors. This will cause other funds to raise their trail commission levels to compete. Existing funds are unlikely to lower their trail commissions as they are obligated by their selling agreements to certain levels. Lowering those levels would require the written agreement of the selling agents, which is unlikely to happen.

We believe that trails of 2% per year would be more appropriate. This would be higher over the long term than other publicly offered securities like mutual fund C shares, reflecting the incentive required for the brokers to maintain NFA registration and provide the investors with the higher level of education and hand holding that is needed to increase the probability of the investor achieving their objectives.

It is our sincere hope that the NASD will reconsider its proposal to cap the trail commissions on publicly offered managed futures funds.

Sincerely,

A handwritten signature in black ink, appearing to read 'Ken Steben', with a stylized, cursive script.

Ken Steben
President