March 12, 2004

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

RE: **NASD Notice to Members 04-07**
Proposed rescission of NASD interpretive policy regarding trail commissions paid by commodity pools (managed futures programs)

I am writing on behalf of Ferris, Baker Watts, Incorporated ("FBW"), a Washington, DC based NASD Member broker/dealer, and an NFA Member Introducing Broker. My role at FBW is manager of the Alternative Investments Department. The Department's product offerings include commodity pools, as well as real estate, oil and gas and equipment leasing Direct Participation Programs ("DPP's"). The Association has requested comments on the proposed rescission of an NASD interpretive policy regarding trail commissions paid by commodity DPPs, more commonly known as managed futures funds. I am therefore replying to the above referenced Notice to Members to express our views.

Before addressing the specific questions asked in the NASD's Notice to Members, I would like to make the following observations:

I believe that commodity pools, also known as managed futures funds, should not be included in the category of Direct Participation Programs, [1] and should not be subject to certain of the regulatory restrictions which the NASD applies to DPP's in general. I believe the current interpretive position re trail commissions reasonably reflects the Association's awareness of certain of those differences.

Many of the differences between commodity pools and DPPs are readily apparent, and provide a compelling basis for the Association's interpretive policy. To wit: Unlike other DPP investments, which typically acquire and hold a defined asset or group of assets, commodity pools are dynamic investments, with the pool of assets changing daily and necessarily subject to active daily management. Not only must an investor's representative monitor the changing pool of assets, he or she must confirm his ongoing trust in the manager by actively monitoring the performance of the manager through changing market cycles. Commodity pools also have no natural life span; they do not hold assets which will stop producing income at some point in the future or be sold once, thereby typically terminating the partnership. Again, commodity pools are dynamic, changing continually, with the opportunity to continue indefinitely. Because of these and other features, commodity pools are subject to additional levels of regulation, including

[1] Notably, the DPP industry itself does not consider commodity pools part of its domain. In fact, the largest DPP trade association, the Investment Program Association, headquartered here in DC, does not include any commodity pool sponsors in its ranks.

both the Commodity Futures Trading Commission and the NFA, while their trading activities themselves are conducted through regulated futures commission merchants on registered commodity futures exchanges. Functionally, they are for most purposes the equivalent of mutual funds and their regulatory structure should reasonably be expected to mirror that applicable to mutual funds. Simply because commodity pools are unlisted, and are legally structured as limited partnerships or trusts are not sufficient reasons to apply regulatory restrictions against unreasonable compensation which should for other legitimate reasons be applicable to DPPs, but not to commodity pools.

Issue Number 1 – Questions:

Do Series 31 associated persons who provide commodity-related services to securities accounts that hold commodity DPPs provide services that are significantly different than those provided by associated persons who are not Series 31 registered?

Response: Yes. The study material for the Series 31 exam provides valuable information about the futures industry and its rules and regulations in addition to providing information about commodity pools and how they work. The successful completion of a study program covering this information, as measured by the Series 31 exam, enables an Associated Person to provide clients with a greater breadth of information concerning the risks, potential benefits, structure, trading strategies and operational issues involved in the investment in, and management of, a commodity pool. Unlicensed persons who sell commodity pools generally have some degree of product knowledge obtained through training meetings, but typically do not have as extensive an understanding of the futures industry and its rules and regulations. Series 31 registered persons typically possess greater knowledge and consequently provide a higher level of quality and service to securities accounts holding commodity pools.

What additional services are provided by Series 31 associated persons?

Response: I would not use the term "additional" services in connection with Series 31 associated persons. Rather, I would employ the term "enhanced" services, as outlined in my preceding response. It has also been my experience that representatives who sell commodity pools and do not obtain Series 31 licenses, make few, and in some cases, single sales. These representatives tend not to take the time or initiative to understand the nature of commodity pools, and as a consequence, positions are frequently redeemed once redemption penalties expire.

If these are necessary services, why are non-Series 31 associated persons permitted to sell shares in such programs?

Response: I would prefer to see the sales of commodity pools limited to only those representatives who hold National Futures Association licenses, either Series 31 or Series 3. Commodity pools are very different and more complex investments than real estate, oil and gas and equipment leasing DPPs. Unlike these DPPs, commodity pools are not in the business of owning and managing hard assets, and the investment objectives of commodity pools do not include the generation of income or delivery of tax benefits. Consequently, I believe investors holding commodity pools in their securities accounts would benefit if their registered representatives were NFA licensed, and FBW would support that additional regulatory requirement.

Issue Number 2 – Question:

Are the higher trail commissions in commodity DPPs [compared to other DPPs, including real estate, oil and gas and equipment leasing partnerships, and 12b-1 fees in the case of mutual funds] justified by the quality and level of service provided to accounts that hold these investments?

Response: I believe that a higher trail commission is justified because typically the quality and level of service provided to accounts that hold commodity pool investments is substantially greater than that provided to accounts that hold either real estate, oil and gas or equipment leasing DPPs, or mutual funds, except in possible circumstances where one of the aforementioned investments encounters problems. Investors are generally familiar with the assets underlying real estate, oil and gas and equipment leasing DPPs. Investors are also generally familiar with stocks and bonds, the assets underlying mutual funds. On the other hand, investors typically are not familiar with commodity pools or how they work, much less why they may be an appropriate addition to their portfolios. Other than treasuries, commodity pools do not own traditional assets. Rather, the assets consist of futures and forward contracts in various commodities. Because commodity pools are different than other investments, our representatives have learned through experience that they require a lot of customer "hand holding". Representatives constantly find themselves explaining the mechanics, operations and other details of commodity pools, as well as portfolio management concepts of diversification and non-correlated returns. They also spend a great deal of time explaining the sometimes counter-intuitive reasons why the risks of a recommended commodity pool are balanced by the portfolio benefits of asset diversification.

Issue Number 3 – Question:

What effect would the trail termination feature have on commodity DPPs?

Response: Terminating trailing commissions once a 10% compensation limit is reached would likely result in commodity pools experiencing a substantial increase in redemptions compared to current levels. Unlike real estate, oil and gas and equipment leasing DPPs that are essentially illiquid, most publicly offered commodity pools feature monthly liquidity, generally without a redemption penalty after 12 months. In addition, monthly redemptions are not limited in amount and must be honored by the commodity pool operator. Redemptions that may be recommended by representatives once a compensation cap is reached may or may not be in the best interests of investors, but could become an unintended consequence of rescinding the current interpretive policy. It is also possible that some portion of redeemed funds would be re-deployed into other commodity pools, which, again, may or may not be in the best interests of investors.

Finally, if the NASD is proposing to cap trailing commissions retroactively, as well as prospectively, which is not specifically addressed in the Notice to Members, it would be overly punitive to representatives who sold commodity pools under prior registration statements that permitted specified, ongoing, annual trailing commissions. The terms of such compensation were described in Selling Agreements, i.e. contracts, that were executed by the sponsor and the selling agent, and were disclosed to investors in the commodity pools' disclosure documents.

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In summary, most participants in the securities industry make decisions on how to serve our clients and conduct our business based upon the needs of our clients and the investment opportunities available at any given time, with a view to building long term sustainable relationships. The current NASD interpretive policy supports those objectives and places clients' objectives in an appropriate alignment with Associated Persons' legitimate expectations of compensation for services rendered. The current compensation structure for Associated Persons who offer commodity pools as investment vehicles to their clients, and undertake the necessary training to qualify to be compensated for continuing to serve clients in those investments, is entirely reasonable and consistent with legitimate regulatory objectives, and has not been the subject of abuse. Commodity pools have met legitimate investor interests by providing greater opportunities for asset diversification while by and large delivering respectable investment returns. There has been no compelling reason advanced for rescinding the interpretive policy and we strongly support its retention.

Sincerely,

Mary-Jean Hanson
Vice President