MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

June 4, 2008

Via Electronic Mail: rule-comments@sec.gov

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Regulation of Compensation, Fees and Expenses in Public Offerings of Real Estate Investment Trusts and Direct Participation Programs; SR-NASD-2005-114

Dear Ms. Morris:

On May 14, 2008, the Securities and Exchange Commission ("Commission" or "SEC") approved Amendment No. 5 to Rule 2810 filed by the Financial Industry Regulatory Authority ("FINRA"). Securities Exchange Act Release No. 34-57803, 73 Fed. Reg. 27869. The Commission stated in its Federal Register notice that it had conducted a "careful review" of Amendment No. 5 and believed that by "clarifying the standards for determining the fairness and reasonableness of compensation" FINRA's changes would be in the public interest and could go into effect immediately. At the same time, the Commission requested public comment on the issues raised by FINRA's rule change.

Managed Funds Association ("MFA") is pleased to have this opportunity to submit a comment on one aspect of FINRA's changes to Rule 2810 -- the inclusion of futures brokerage trail commissions within the Rule 2810 limits on underwriting compensation.[1] In the Rule 2810 context, futures brokerage trail commissions are a portion of the payments made by public commodity pools to futures commission merchants or introducing brokers for futures execution and account services. The futures firms then allocate the portion of the commission to qualifying individuals. Those individuals must be both SEC-registered representatives affiliated with a registered broker-dealer and associated persons registered under the Commodity Exchange Act ("CEA") who sold investors interests in the pool and, most importantly for purposes of the rule change in question, provide ongoing services to those investors. From 1982-2004, FINRA's

[1] MFA is the voice of the global alternative investment industry. MFA members include professionals in hedge funds, funds of funds and managed futures funds. Established in 1991, MFA is the primary source of information for policymakers and the media about the global alternative investment industry and the leading advocate for sound business practices and industry growth. MFA is headquartered in Washington, D.C., with an office in New York.

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predecessor, National Association of Securities Dealers, Inc., or NASD, considered those brokerage commissions not to be underwriting compensation.[2]

In 2004, FINRA reversed field and announced the view perpetuated in subsequent amendments to Rule 2810, that futures brokerage trail commissions paid by public commodity pools would be deemed to be underwriting compensation subject to the limits imposed by Rule 2810. By this letter, MFA reiterates its request that the Commission reinstate FINRA's 1982 de facto rule excluding futures brokerage trail commissions from the Rule 2810 limits and abrogate FINRA's change to Rule 2810 that now treats such commissions as underwriting compensation. In the alternative, MFA requests that the Commission direct FINRA to reconsider its 2004 decision and resubmit any rule change it adopts in accordance with Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act").

FINRA's 2004 reversal decision was flawed as a matter of law and policy, as MFA explained previously.[3] FINRA failed to articulate a rational, let alone compelling, basis for reversing its 22 year policy and legal interpretation that qualifying futures brokerage trail commissions were not underwriting compensation for purposes of Rule 2810. No change in facts or law precipitated or supported FINRA's action. No evidence of investor harm or abuse was, or could have been, cited by FINRA to justify its reversal. FINRA also did not take into account that, under the CEA, futures brokerage trail commissions are paid with respect to "accounts, agreements and transactions" "involving contracts of sale of a commodity for future delivery" and therefore are subject to the exclusive jurisdiction of the Commodity Futures Trading Commission ("CFTC"). 7 U.S.C.§ 2(a)(1)(A).

Instead, in 2004 FINRA reversed its 1982 determination in order to create what it saw as a level playing field for commodity pools with direct participation programs ("DPPs"), a result, FINRA concluded would not affect the future availability of commodity pools to investors. NASD Notice to Members 04-50 (July 13, 2004), SEA Release 34-50065, 69 Fed. Reg. 45870, 45871 (July 30, 2004). FINRA erred on both counts. FINRA's new policy actually creates an unfair and unlevel playing field for public commodity pools which are already subject to unique regulatory burdens that other DPPs do not face. The available evidence also demonstrates that

[2] "Since 1982, [NASD/FINRA] has had a policy to exclude trail commissions from the 10 percent limitation as it applies to commodity DPPs if: 1) the member is registered with the Commodity Futures Trading Commission as a futures commission merchant; (2) the associated person receiving the trail commissions has passed the Series 31 Futures Managed Funds examination; and (3) the associated person receiving the trail commissions provides ongoing investor relations services to investors." NASD Notice to Members 04-07 (Feb. 2004). Over time, this NASD/FINRA determination was extended to registered associated persons that passed the Series 3 or Series 31 examination.

[3] See MFA letter to the Commission dated October 7, 2004 in response to SEA Release No. 34-50335, MFA letter to the Commission dated August 20, 2004 in response to SEA Release No. 34-50065, and MFA letter to NASD dated March 12, 2004 in response to NASD Notice to Members 04-07. MFA's October 2004 letter urged the Commission to find FINRA's change to Rule 2810 to be invalid procedurally and inconsistent with the substantive Exchange Act standards. That letter attached and incorporated the arguments from our August 2004 and March 2004 letters as well. MFA is attaching each of those letters here and incorporating those arguments again. While the Commission never responded to the October 2004 comment letter in any way, MFA is hopeful the Commission will now do so.

after FINRA's reversal in 2004, the market for public commodity pool offerings in the U.S. has shrunk considerably, despite the public benefits those funds provide.

In this letter, MFA shows 1) the futures brokerage trail commissions issue was never properly approved by the Commission, has never been addressed, let alone resolved, by the Commission and its consideration of that issue now is ripe and timely; 2) futures brokerage trail commissions are covered by the exclusive jurisdiction of the CFTC which supersedes FINRA's authority in this area; and 3) approval of FINRA's inclusion of futures brokerage trail commissions within its underwriting compensation limitation is contrary to the public interest of investors, unfairly discriminates against both pool sponsors and the individuals qualified to receive them and imposes an undue burden on competition.

Procedural Considerations

The text of Amendment No. 5 confirms that the futures brokerage trail commissions issue is still ripe for Commission review and action. FINRA's Amendment No. 5 proposes to amend Rule 2810, in pertinent part, as follows, with the rule change additions provided by FINRA underlined:

> (B) In determining the fairness and reasonableness of organization and offering expenses that are deemed to be in connection with or related to the distribution of the public offering for purposes of subparagraph (A) hereof, the arrangements shall be presumed unfair and unreasonable if:
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> * * *
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> [(i)](ii) the total amount of all items of compensation from whatever source, including compensation paid from offering proceeds and in the form of "trail commissions," payable to underwriters, broker/dealers, or affiliates thereof[, which are deemed to be in connection with or related to the distribution of the public offering,] exceeds an amount that equals ten percent of the gross proceeds of the offering (excluding securities purchased through the reinvestment of dividends) [currently effective compensation guidelines for direct participation programs published by the Association; …

Amendment No. 5, pages 16-17. For purposes of determining whether a public commodity pool offering contemplates fair and reasonable organization and offering expenses, Amendment No. 5 adds, by the underlined language, "compensation … in the form of 'trail commissions'" to the 10% limitation. The proposed rule change described in and made by Amendment No. 5 therefore raises explicitly, and from FINRA's own perspective, in a duplicative procedural step, the futures brokerage trail commissions issue, making it appropriate for the Commission to address the issues raised at this time.

FINRA may try to block Commission consideration of the merits of the futures brokerage trail commissions issue, as it has in the past. Just last month, FINRA insisted that the Commission should disregard as procedurally out of time a thoughtful comment letter filed by R.J. O'Brien Fund Management, LLC ("R.J. O'Brien") on this issue on April 28, 2008. R.J. O'Brien's letter was filed after FINRA Amendment No. 4 to Rule 2810 which indicated that the words "including

… trail commissions" were technically part of the rule change. See SEA Release, 34-57199, 73 Fed. Reg. 5885 (Jan. 31, 2008); FINRA Amendment No. 4 (Jan. 2, 2008). The "trail commissions" language had been included in prior iterations of Rule 2810. The Commission, however, has never addressed the substance of the trail commissions issue. The R.J. O'Brien letter assumed therefore that the issue was still open and its comments addressing those brokerage commissions payments were timely and appropriate. The Commission should have responded to the points raised in that letter.

Yet FINRA claimed the issues raised by R.J. O'Brien "were addressed by the SEC in an approval order issued in a prior rulemaking proceeding. See SEA Release No. [34-]50335 (Sept. 9, 2004) ….". 73 Fed. Reg. 27869, 27872 n.27 (May 14, 2008). SEA Release No. 34-50335, however, does not contain any Commission approval or articulated policy basis for approving FINRA's 2004 policy reversal. 69 Fed. Reg. 55855 (Sept. 16, 2004). To the contrary, the Commission in 2004 recited that FINRA had "designated the proposed rule change as constituting a stated policy, practice or interpretation with respect to the meaning, administration or enforcement of an existing rule of NASD under Section 19(b)(3)(A)(i) of the Act and Rule 19b-4(f)(1) thereunder, which renders the proposal effective upon receipt of this filing by the Commission." *Id*. Then, the Commission wrote: "The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons." *Id*.

The Commission described FINRA's rule change in September 2004 as "proposed" because it was not Commission "approved" as FINRA now contends. As that Commission release confirms, the rule change was declared effective by operation of law based on FINRA's erroneous assertion that it was a mere interpretation, but never received Commission approval. SEA Release 34-50335, 69 Fed. Reg. 55855 (Sept. 16, 2004). For that reason, in 2004, MFA submitted comments to the Commission in October 2004 on the proposed rule change. See note 3 *supra*. MFA raised objections to both the procedures FINRA followed because it submitted a substantive rule change in the guise of an interpretation and the substance of FINRA's new position. To date, the Commission has never addressed any issues raised by those comments. In MFA's view, the Commission now should consider and act upon the legal and policy issues raised by FINRA's substantial rule change concerning payments in the form of futures brokerage trail commissions as embodied in Rule 2810.[4]

[4] The failure of the Commission to respond to the filed public comments or explain the basis for any determination on futures brokerage trail commissions would be grounds for invalidating the Commission's actions in relation to FINRA's changes to Rule 2810. See Board of Trade of the City of Chicago v. SEC, 883 F.2d 525, 536 (7th Cir. 1989) citing SEC v. Chenery Corp., 318 U.S. 80, 88 (1943).

Jurisdictional Issues

The CFTC has exclusive jurisdiction over futures brokerage trail commissions. 7 U.S.C. § 2(a)(1)(A). Neither FINRA nor the Commission has authority to transform those commissions into underwriting compensation. As FINRA's 1982 position confirmed, futures brokerage trail commissions were not underwriting compensation and should not be subject to any limits under Rule 2810. For twenty-two years after FINRA adopted its 1982 position, it respected the CFTC's exclusive jurisdiction and its own corresponding jurisdictional limits. FINRA's 2004 reversal decision and subsequent rule changes, however, contravene CFTC exclusive jurisdiction and should be abrogated, with Rule 2810 returned to its 1982 status in this area.

Futures Brokerage Trail Commissions.

Under the CEA, futures brokerage firms, called futures commission merchants ("FCMs") or introducing brokers ("IBs"), must be registered with the CFTC and become members of the National Futures Association ("NFA"). 7 U.S.C. §§ 1a(20), 1a(23), 6d(a), and 21(m); CFTC Rules 3.2, 3.4 and 170.15(b); NFA Bylaw 1101. Futures brokerage commissions are fees for services paid by customers to FCMs and IBs and are regulated by the CFTC as well as NFA to promote fair dealing and to prevent fraud. These fees are the subject of an agreement reached between a futures customer and the FCM or IB. The services covered by the brokerage commissions often include the acceptance and execution of futures customer orders and the provision of ongoing advice and services relating to trading in, and the operations of, the futures markets. The FCMs and IBs may share portions of these commissions with their employees, called associated persons ("APs"), if they are registered APs with the CFTC and members of NFA. 7 U.S.C. §§ 6k(1) and 21(m); CFTC Rules 3.2, 3.4, and 3.12; NFA Rule 1003.3. If a customer opens an individual futures trading account with an FCM, for example, as a result of sales efforts of the FCM's AP, and that AP would perform continuing services to the customer, the FCM may share its brokerage commissions paid by that customer with the AP due to the continuing services the AP provides to the customer.

Some FCM customers are commodity funds or pools. These collective investment vehicles afford investors the ability to enjoy the benefits of professional management while participating in futures markets through a structure where the investor's risk typically is limited as a limited partner or otherwise. The operators of a commodity pool ("CPOs") and futures trading advisors ("CTAs") who make trading decisions for the pool also are CFTC registered and regulated, and must be NFA members as well. 7 U.S.C. §§ 1a(5), 1a(6), 6m(1) and 21(m); CFTC Rules 3.2, 3.4; NFA Bylaw 1101. For many years, publicly offered commodity pools were popular investment vehicles that allowed non-accredited investors to diversify their investment portfolios and participate in futures markets through the services of professional trading advisors with transparent and extensive track records. See *Money Under Management in Managed Funds*, Barclay's Hedge, (showing the growth in all managed funds since 1980), available at http://www.barclayhedge.com/research/indices/cta/Money_Under_Management.html (last accessed June 4, 2008).

Like other public securities offerings, the offer and sale of interests in a commodity pool are subject to the Securities Act of 1933. No one questions the authority of FINRA to regulate the

underwriting compensation for public offerings of securities. But no one has ever maintained that futures brokerage commissions constitute securities underwriting compensation.

For decades, public commodity pool offerings regularly disclosed that FCMs would allocate a portion of the futures brokerage commissions received from the commodity pool to qualifying APs. This allocation would not increase in any way the amount of futures brokerage commissions a pool would pay. Instead, the monies paid to qualifying APs would come out of the FCM's futures brokerage commissions and would be allocated to APs who sold interests in public commodity pools and whose sponsoring firms agreed to and provided services to investors so as to facilitate the investors' understanding of the intricacies of futures markets, which the U.S. Supreme Court and the Congress have described as "volatile and esoteric." *Merrill Lynch vs. Curran*, 456 U.S. 353, 356 (1982). This practice became known as futures brokerage trail commissions.

Starting in 1982, and continuing until 2004, FINRA, through its predecessor NASD, determined under certain criteria that were applied in the course of reviewing the sales compensation terms pertaining to publicly offered commodity pools and under which futures brokerage commissions could be allocated to qualifying APs without counting as underwriting compensation. "Since 1982, [NASD/FINRA] has had a policy to exclude trail commissions from the 10 percent limitation as it applies to commodity DPPs if: 1) the member is registered with the Commodity Futures Trading Commission as a futures commission merchant; (2) the associated person receiving the trail commissions has passed the Series 31 Futures Managed Funds examination; and (3) the associated person receiving the trail commissions provides ongoing investor relations services to investors." NASD Notice to Members 04-07 (Feb. 2004). (Subsequently, that determination was extended to registered IBs and APs who passed the Series 3 examination.)

The services provided by APs that may receive futures brokerage trail commissions require knowledge of both commodity pools and the futures markets. These services, as generally described in the prospectuses of publicly offered commodity pools and historically required through NASD review and comment letters, 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; (e) assisting investors in redeeming units; and (f) providing other services requested from time to time by investors. These services exceed what may be provided in the context of mutual funds, exchange-traded funds, and exchange-traded notes.

FINRA applied its qualification criteria excluding futures brokerage trail commissions from underwriting compensation to hundreds of commodity pool offerings from 1982 until 2004. Without citing any abuses, FINRA reversed its policy in 2004 and declared futures brokerage commissions allocated by FCMs in accordance with FINRA's 1982 determination would thereafter be considered to be underwriting compensation. NASD Notice to Members 04-50 (July 13, 2004); SEA Release 34-50065, 69 Fed. Reg. 45870 (July 30, 2004); SEA Release 34-50335, 60 Fed. Reg. 55855 (Sept. 16, 2004). As a consequence, the futures brokerage trail commissions now are counted toward the 10% limit on underwriting compensation under FINRA Rule 2810.

Futures Brokerage Trail Commissions are Subject to CFTC Exclusive Jurisdiction.

As the Commission well knows, Congress provided in the CEA that the CFTC "shall have exclusive jurisdiction … with respect to accounts, agreements … and transactions involving contracts of sale of a commodity for future delivery," also known as futures contracts. 7 U.S.C. § 2(a)(1)(A). Futures brokerage commissions are paid as a result of a commodity pool's agreement with its FCM or FCMs for transactions involving futures trading activity. Futures brokerage trail commissions are paid by the FCMs to qualifying APs again as a result of agreements between the pool's FCM and the AP's sponsoring FCM or IB firm which surely "involve" futures trading activity.

Based on the plain meaning of the statute's terms, futures brokerage trail commissions fit comfortably within the CEA's grant of exclusive jurisdiction. Courts have made clear that matters committed to the CFTC's exclusive regulatory jurisdiction are not subject to any regulation by other federal or state agencies, even if those agencies would otherwise have been able to assert jurisdiction. See *CME vs. SEC* (IPs case), 883 F.2d 537 (7th Cir. 1989) and *Board of Trade of the City of Chicago vs. SEC* (GNMA Options case), 677 F.2d 1137 (7th Cir. 1982). As FINRA's authority is derived from the Exchange Act, and that statute has been superseded by Congress for those matters subject to CFTC exclusive jurisdiction, FINRA has no authority to treat as underwriting compensation any portion of the futures brokerage commission paid to an FCM and qualifying APs.

FINRA may claim Section 4m(2) of the CEA, as enacted in 1982, supports its effort to override CFTC exclusive jurisdiction. 7 U.S.C. § 6m(2). Section 4m(2) provides: "Nothing in this Act shall relieve any person of any obligation or duty … arising under the Securities Act of 1933 or the Securities Exchange Act of 1934 governing the issuance, offer, purchase, or sale of securities of a commodity pool, or of persons engaged in transactions with respect to such securities, or reporting by a commodity pool." Under these provisions, FINRA might try to argue it has jurisdiction because futures brokerage trail commissions implicate the duty of commodity pool sponsors not to pay more than 10% in underwriting compensation in connection with the offer of securities of a commodity pool. But FINRA's 1982 decision <u>not</u> to treat qualifying futures brokerage trail commissions as underwriting compensation effectively blocks FINRA from logically making that claim. At the same time Congress was enacting Section 4m(2), FINRA had determined that these futures brokerage commission payments were not underwriting compensation. And FINRA continued that legal interpretation for over 20 years. Surely Congress could not have intended FINRA to regulate as underwriting compensation futures brokerage commissions that FINRA stated publicly were not underwriting compensation. Section 4m(2) offers little help to FINRA on this issue.

<u>FINRA's 1982 Trail Commission Determination Satisfied the Exchange Act's Standards, Its 2004 Reversal Does Not.</u>

FINRA rules must generally satisfy the public interest as well as avoid unfair discrimination and not burden competition unless necessary to achieve the Exchange Act's objectives. Exchange Act, Section 15A(b)(6). FINRA's decision to treat futures brokerage trail commissions as underwriting compensation subject to the 10% limit replaced a policy that met the statute's

requirements with one that does not. Even if the Commission believes that FINRA has jurisdiction over futures brokerage trail commissions, the Commission should abrogate FINRA's 2004 reversal of its 1982 determination or direct FINRA to reconsider its 2004 decision. Indeed, like the Commission and other agencies, FINRA bears a heavy burden when it reverses regulatory course and rescinds one of its rules. See *Motor Vehicle Manufacturers v. State Farm*, 463 U.S. 29, 42 (1983) ("an agency changing its course by rescinding a rule is obligated to supply a reasoned analysis for the change beyond that which may be required when an agency does not act in the first instance").

Public Interest Considerations.

Since their inception decades ago, publicly offered commodity pools have had no history of abuses; and, more specifically, there has been no history of abuses connected with the payment of futures brokerage trail commissions. Prior to FINRA's reversal of its 1982 determination, public commodity pools were becoming increasingly popular, as interest in the benefits provided by managed futures and other alternative investments has grown among the retail investing public. In response to that increased interest and the resulting competitive pressures prior to the FINRA reversal, the number of public commodity pools in the United States had increased and the fees paid by such pools had decreased. In particular, advisory and brokerage fees paid by public commodity pools were substantially reduced, presumably as the result of competition, which benefit investors.

When publishing its reversal decision in 2004, FINRA noted: "staff believes that notwithstanding a limit on the level of underwriting compensation, firms and registered representatives will continue to offer and recommend commodity pool DPPs." NASD Notice to Members 04-50 (July 13, 2004); SEA Release 34-50065, 69 Fed. Reg. 45870, 45871 (July 30, 2004). Available data suggest that, contrary to FINRA's stated expectation, its policy reversal has resulted in a sharp decline in the number of public commodity pools. The annual average number of registered public commodity pool offerings from 1997-2003 was over 12. From 2005-2007, that annual average fell to 4.[5]

As these data show, since 2004, public investors have faced dwindling opportunities to diversify their investment risk exposures by participating in commodity futures markets through professionally managed commodity pool offerings. As a result, the benefits of commodity pools as investment alternatives are less accessible to the investing public.

Last, Congress has identified price discovery as one of the main public interest functions of futures trading. 7 U.S.C. § 5(a). In order for futures markets to perform this function, both speculators and hedgers must use the markets. Public commodity pools provide a significant source of trading capital (both long and short), provide liquidity to the futures markets, and facilitate transparent and balanced price discovery and efficient risk transference. FINRA's new

[5] These data exclude exchange traded funds. We also have not included pool offerings for the year 2004, in our annual figures although the number of offerings in 2004 would have substantially increased the annual average number of public commodity pool registrations for the period immediately before FINRA's new trail commission rules went into effect. Some may claim that the effective date and grandfathering under the prior policy might have skewed the data on the impact of FINRA's new policy, so we disregarded those data.

policy on trail commissions 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.

Public 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 historically non-correlated investment to a traditional stock and bond portfolio. Typically, a commodity pool raises capital through the sale of pool interests, such as shares or units of limited partnership, through either a public offering or a private placement of securities. The commodity pool's capital is thereafter invested in Treasury bills and/or maintained in cash or cash equivalents, which is then used for margin for the pool's trading.

The principal acknowledged benefits provided by public commodity pools include:

- limited liability for investors;
- access to professional management at a greatly reduced minimum investment amount;
- transparency of investment activities (e.g. independently determined daily settlement prices) resulting in daily net asset valuation;
- monthly or even daily investment liquidity through redemption rights;
- the ability to take short or long positions in futures and options contracts on energy products, industrial goods, metals, agricultural and "soft" commodities, stock indices, and interest rates as well as in futures, forwards, and options contracts on global currencies; and
- an environment of strong, multi-agency regulatory oversight through firm and associated person registration requirements, disclosure requirements, suitability standards, and solicitation restrictions.

Alternative means of accessing the futures and forwards markets, such as individual managed accounts and private placement offerings, often fail to provide similar benefits to investors, and may result in unlimited liability for investors, restricted access to professional management, less regulatory oversight and higher fees.

Public commodity pools are highly regulated by the CFTC, NFA, Commission, and state blue sky regulators 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, FINRA or state securities law jurisdiction and have unlimited liability, typically higher fees, restricted access to advisors and less regulatory oversight. And, of course, individually managed futures accounts may have futures brokerage trail commissions.

Moreover, public commodity pools provide retail investors with access to many of the most successful CTAs. This access would be severely curtailed for public investors if public 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 net worth obligations for investors in privately offered commodity pools. In addition, portfolio diversification is a basic tenet of modern investment theory. Commodity pools generally provide investors with the potential to enhance portfolio returns and reduce overall portfolio volatility by diversifying beyond traditional investments, such as stocks and bonds, into historically non-correlated managed futures. Consequently, the diversification benefits of managed futures have made commodity pools an important element of an individual investor's overall portfolio diversification strategy. In fact, most pools offered today are sold as a portfolio diversification strategy.

If FINRA's 2004 reversal decision is undisturbed and as a result, the number of publicly offered commodity pools is severely reduced as we have seen in the last three years, 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, limited liability company or other limited liability entity) and to one of the only alternative investment products available to diversify a traditional stock and bond portfolio. That can not serve the public's interests.

Trail Commissions Are Fair.

Futures brokerage 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 futures brokerage commissions generated by the accounts. In fact, the qualification requirements applicable to APs receiving futures brokerage trail commissions from pools are similar to those applicable to APs who limit their activities to individual customer futures accounts.

APs who received futures brokerage trail commissions under the 1982 policy must qualify by registering as APs 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. See NASD Notice to Members 04-07 (Feb. 2004). As registrants under the CEA, these individuals are subject to sanctions under the CEA and related rules (including those of the CFTC and NFA). 7 U.S.C. § 6k(1); CFTC Rule 3.12; NFA Rules 3-14 and 1003.3. APs are also subject to periodic ethics training requirements. 7 U.S.C. § 6p(b).

As noted above, commodity pools are often sold as a portfolio diversification strategy. Consequently, APs may be required to monitor the traditional elements of an investor's portfolio as well as the futures component. CPOs retain selling agents with registered representatives who are also registered as APs of FCMs and IBs in order to perform those service functions. If APs 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.

FINRA's primary stated reason for changing its policy on futures brokerage trail commissions was to treat commodity pools the same way as "other DPPs." NASD Notice to Members 04-50 (July 13, 2004); SEA Release 34-50065, 69 Fed. Reg. 45870, 45871 (July 30, 2004). Publicly offered commodity pools should not be treated in the same manner as other DPPs because public commodity pools are materially different. Among the distinguishing features of commodity pools are the breadth of futures-related interests traded, the rapid turnover of a managed futures portfolio's holdings, the frequency of daily net asset valuations and monthly investment liquidity, and the continuous nature of the offering.

Publicly offered commodity pools also differ from other DPPs 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. These DPPs invest in relatively illiquid assets, whereas commodity pools typically invest in only the most liquid types of instruments. Although these DPP 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 and liquidity restrictions require that proper written notice of redemption be provided to the pool operator. In addition, most commodity pools engage in continuous offerings of interests, at least until such time as a maximum level of assets is reached.

Unlike other DPPs subject to NASD Rule 2810, suitability standards require that each investor in publicly offered commodity pools completes a subscription agreement wherein the investor represents that the investment is suitable and that the investor agrees to terms such as risk factors, conflicts and liquidity restrictions. CFTC reporting requirements require that commodity pools send monthly to each investor current financial statements for the pool as well as a narrative describing the prior month's activity and the client's individual investment valuation. Publicly offered commodity pools are required to file monthly Prospectus Supplements on Form 424(b)(3) with this information.

In addition, commodity pools are subject to other special regulatory requirements, which 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, and at the operational level, the CFTC's regulation is supposed to be exclusive. Those selling commodity pools and providing services to investors therein are required to have certain types of training and a minimum level of competency in order to receive trail commissions, while no similar standard exists with respect to other DPPs.

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, many states have adopted the North American Securities Administrators Association Guidelines for Registration of Commodity Pool Programs, 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 futures

brokerage trail commissions. In contrast, states do not review the prospectuses of registered investment companies and almost anyone can purchase shares in them.

Because commodity pools are structured as limited partnerships for income tax purposes, investors receive a Form K-1 for annual income tax reporting compared with the more familiar Form 1099 that is received for mutual funds or stock investments. A commodity pool's activities make the tax attributes more complex than those reported in Form 1099. For example, certain contracts that trade on U.S. exchanges are characterized as Section 1256 contracts and treated as 60% long-term and 40% short-term capital gain or loss, where other contracts are short-term. Other tax items need to be reflected in specific tax forms such as Schedule E. These and other tax attributes of the pools make it more difficult for investors and their accountants to understand these investments. Investors often ask APs questions about these tax complexities. As a result of these differences, investors require more and different information than investors in other DPPs as well as additional time with APs to administer these processes.

FINRA ignored these unique features of public commodity pools and adopted a rule change which discriminates against these offerings by trying to homogenize them with other DPPs. But see Exchange Act, Section 15A(b)(6) (requiring that FINRA's rules promote just and equitable principles of trade and not discriminate). Put simply, lumping futures brokerage trail commissions, paid by an already operating commodity pool, into underwriting compensation in effect grants other DPPs a serious competitive advantage compared to commodity pools. The other DPPs, which already enjoy an advantage in lower regulatory expenses (no CFTC or NFA regulation or review of offering materials, for example), may pay 10% in true underwriting compensation to those that sell interests in their offerings. If a commodity pool pays the same 10% compensation, under the change to Rule 2810, the pool may not allocate any monies from its brokerage commission to an AP that is providing ongoing services for investors in that pool. APs would be forced to provide these services without compensation once a pool is operational, services for which they would surely be compensated if the investors opened individual managed accounts, rather than make a pooled investment. As the data cited earlier shows, the decline in the number and size of public commodity pool offerings supports a finding that FINRA's rule change has discriminated against public commodity pools and inflicted real competitive harm.

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Conclusion:

MFA appreciates the opportunity to comment on the rule changes to FINRA Rule 2810. We support the Commission's efforts to protect investors and to promote competitive securities markets. In our view, however, FINRA has exceeded its legal authority by attempting to regulate and limit futures brokerage trail commissions. And, even if FINRA had authority to treat those brokerage commissions for regulated service providers as underwriting compensation, its 2810 rule changes are not sound public policy and should be abrogated by the Commission under the Exchange Act, while reinstating FINRA's trail commission determination from 1982. In the alternative, the Commission should direct FINRA to reconsider its changes to Rule 2810 and resubmit its rules under Section 19(b)(1) of the Exchange Act for full Commission consideration.

Please feel free to call me at (202) 367-1140 if you have any questions or comments. We would be pleased to meet with Commissioners or Staff to discuss our comments.

Sincerely,

Richard H. Baker
President and Chief Executive Officer

Enclosures

CC: The Hon. Christopher Cox, Chairman
The Hon. Paul S. Atkins, Commissioner
The Hon. Kathleen L. Casey, Commissioner
Dr. Erik Sirri, Director
Division of Trading and Markets

The Hon. Walter Lukken, Chairman
The Hon. Michael Dunn, Commissioner
The Hon. Jill E. Sommers, Commissioner
The Hon. Bart Chilton, Commissioner