MANAGED FUNDS ASSOCIATION

November 27, 2006

VIA ELECTRONIC MAIL: peter.cassidy@sec.state.ma.us

Peter Cassidy, Esq.
Project Group Chair
Office of the Secretary of the
Commonwealth
Securities Division
One Ashburton Place – Room 1701
Boston, MA 02108

Re: NASAA Proposed Revisions to Statement of Policy for the Registration of Commodity Pool Programs

Dear Mr. Cassidy:

Managed Funds Association ("MFA") appreciates the opportunity to submit comments to the members of the Direct Participation Programs Policy Project Group (the "Project Group") of the North American Securities Administrators Association ("NASAA") regarding its proposed revisions to the NASAA statement of policy on the registration of commodity pool programs ("Proposed Revisions").

MFA is the leading U.S.-based membership organization dedicated to serving the needs of professionals who advise, manage and operate commodity pools, as well as hedge funds, and funds of hedge funds. MFA has over 1,200 members, including commodity pool operators ("CPOs"), commodity trading advisors ("CTAs"), and futures commission merchants, as well as NASD-member broker-dealers, who provide their respective services in connection with a significant portion of the estimated $149.5 billion invested in managed futures products, including publicly offered commodity pools. Accordingly, MFA's members have a keen interest in the amendments set forth in the Proposed Revisions relating to suitability standards.

Proposed Revisions

We appreciate the Project Group's efforts to update and enhance the suitability standards in the NASAA Guidelines for Direct Participation Programs ("DPP"). We support the Project Group's revision of the net income and net worth values and believe the revisions are appropriate to compensate for inflation. We do not agree, however, with the Project Group's revision of the definition of the term net worth ("Net Worth") of the investor to exclude retirement assets or of the 10% participant net worth maximum investment cap. Whenever possible, we believe it best to maintain consistency with the

2025 M Street, N.W. Suite 800 Washington, DC 20036-3309 Tel: 202.367.1140 Fax: 202.367.2140
Web site: www.mfainfo.org

standards (including definitional) of the federal securities law to prevent investor confusion, and to avoid the complexity and costs associated with administering different standards that do not bring offsetting benefits. We believe these revisions will deprive investors of alternative investment options, as well as curtail the growth of the public commodity pool industry. Accordingly and as further discussed, we respectfully request that the Project Group not adopt these two revisions.

I. Proposed Revision to the Definition of the Term Net Worth

The Project Group proposes to revise Section III.B.2 of the Statement of Policy for the Registration of Commodity Pool Programs by revising the definition of Net Worth to exclude "any and all retirement or pension plan accounts or benefits" (together "Retirement Accounts"). In setting forth the proposed revision, the Project Group explains that the purpose of the exclusion is "to limit the retirement proceeds at risk in the DPP programs" and that "The Project Group does not believe that investors wish to or can sell many retirement assets to make up for current losses or potential losses from DPP programs." MFA believes that many of the Project Group's concerns behind the proposed revision of the definition of Net Worth are laudable, but that the proposed revision is unnecessary and would lead to inconsistent outcomes and unintended consequences.

Public commodity pools are regulated by the Commodity Futures Trading Commission ("CFTC"), Securities and Exchange Commission ("SEC"), National Futures Association ("NFA"), and the National Association of Securities Dealers ("NASD"), and are subject to both substantive and disclosure requirements under various state blue sky laws. Public commodity pools are subject to extensive regulation, and so differ from other programs subject to various NASAA guidelines. The Project Group indicates that Retirement Accounts, like a home, home furnishings and automobiles, should be excluded from Net Worth, because these assets are "illiquid" and "difficult to value." Defined benefit plans may be illiquid or difficult to value, however, these days fewer employers offer pension plans and a greater portion of retirement assets are held in defined contribution plans. We believe that most assets typically held in retirement accounts are easy to value and may be readily sold when necessary. Most often, assets in such accounts are held in whole or part at broker-dealers, invested in various types of securities, valued daily, and may be sold when directed by the owner of the account or the person directing the investment of a plan.

The Project Group states that it is concerned that an investor may have to sell retirement assets to make up for losses in a DPP. We believe that this belief is misguided as related to interests in public commodity pools. Like an investment in a mutual fund or in stock of a corporation, an investor in a public pool is not required to commit additional money beyond his or her investment, which is a major benefit of investing in a commodity pool. Professionally managed pools offer the benefit of capping any losses at the size of an investor's investment, whereas investing directly in futures subjects one to the possibility of unlimited losses. Thus, an investor in a commodity pool would never have to sell retirement assets, or any other assets for that matter, to make up for losses in a pool in a

manner that differs from an investment in any other asset that insulates the investor from liability beyond the amount of his or her investment.

Over the last twenty-five years, the NFA, the self-regulatory organization charged with overseeing public commodity pools, has never needed to file an enforcement action against an NFA member relating to the sale of a public commodity pool, and has stated that it cannot recall a single arbitration case filed by a public commodity pool customer. With little or no history of customer abuse relating to the sale of interests in, or the operation of, public commodity pools, we believe it is inappropriate and unnecessary for the protection of investors to exclude Retirement Accounts from the definition of Net Worth. The proposed revision purports to solve a problem that doesn't exist. Such a revision, however, would preclude many investors from being eligible to invest in public commodity pools, and in effect, deprive investors of the opportunity to diversify their assets through investment exposure in public commodity pools. Furthermore, public commodity pools may be the best vehicle through which investors can access the futures markets, because of the limited liability features of these funds and the availability of professional management. Public pools also offer more liquidity than many other forms of alternative investments. Many, if not most, pools offer redemptions monthly or more frequently (e.g., some pools offer daily redemptions), and in all cases, investors redeem interests at the current net asset value, which is derived from publicly available third party pricing sources. We believe that redefining Net Worth as proposed provides investors with no additional protection and merely serves to limit investor choices.

We are also concerned that revising the definition of Net Worth would result in inconsistent outcomes. Congress does not restrict investors from purchasing alternative investments in Retirement Accounts. Thus, investors are free to buy interests in alternative investments in, for example, a 401(k) plan, an Individual Retirement Account ("IRA") or a Keogh plan. It seems largely inconsistent for money in an investor's retirement accounts to be excluded from Net Worth when an investor may readily access money in those accounts, such as from a 410(k) plan, an IRA or a Keogh plan to invest in alternative investments. In addition, for those of retirement age, and for all others with retirement accounts, albeit upon payment of certain taxes and penalties, money in these accounts is readily accessible if needed. It is fairly common for investors to devise, either alone or with the assistance of professional advisors, an investment scheme that encompasses all of their assets, including Retirement Accounts. A perverse and inconsistent outcome of excluding Retirement Accounts from the definition of Net Worth may be that investors will contribute less money to, or withdraw money from retirement accounts in order to meet the suitability standards to purchase interests in alternative investment vehicles, such as public pools or, for that matter, other investment programs subject to NASAA guidelines, in order to obtain greater investment diversification options and to meet their desired investment allocations. In addition, it is unclear how Net Worth would be calculated when an investor purchases or owns interests in alternative investments in his or her Retirement Accounts. We maintain that it is important to continue providing investors the option to diversify their retirement portfolio and their other assets through alternative investments. We believe that Congress did not see fit, and that you should also not see fit,

to force investors to change their desired investment mix, whether assets are held in retirement or non-retirement accounts, in an artificial manner so as to accommodate what we believe to be an unnecessary regulation.

We are also concerned that revising the definition of Net Worth would have the unintended consequence of curtailing the growth of the public commodity pool industry. This would further limit the number of public commodity pools and alternative investment options available to investors. The number of new public commodity pools available to investors is already limited. For example, since October 2004, there have only been nine new public pool offerings.[1]

Thus, with the misconception that an investor would potentially have to sell retirement assets to cover losses dispelled and with little or no history of customer abuse relating to the sale of interests in a public commodity pool, we believe revising the definition of Net Worth to exclude Retirement Accounts is inappropriate and unnecessary. By contrast, to do so, would deprive investors of alternative investment options, lead to inconsistent outcomes, and curtail the growth of the public commodity pool industry. We respectfully request that the Project Group not revise the definition of Net Worth to exclude Retirement Accounts.

II. Proposed Maximum Investment Clause

The Project Group proposes to revise Section III.F. to include the statement "The maximum investment in the PROGRAM and AFFILIATES and other investments with similar investment objectives may not exceed 10% of the PARTICIPANT'S NET WORTH." MFA believes this proposed revision is inappropriate, an ineffective test for suitability, and would be difficult and costly to administer. Moreover, we believe that such a revision, rather than promote diversification, would ultimately impede investors from properly diversifying.

The Project Group states that the purpose of the proposed revision is to provide a diversification standard to limit excessive concentration of an investor's assets in an issuer. We are unaware of any problems relating to excessive concentration of an investor's assets in a public pool, and with little or no history of customer abuse relating to the sale of interests in, or the operation of, public commodity pools, we believe additional regulation is inappropriate and unnecessary. We believe the proposed clause proposes costly restrictions as a solution to a non-existent problem. Public commodity pools themselves offer the benefits of diversification and professional money management, and many, if not all, brokerage firms that sell public commodity pool interests already apply guidelines to limit the amount of a portfolio that an investor applies to futures investments.

---

[1] Provided by NFA.

A) The Proposed Clause is an Ineffective Test for Investor Suitability.

MFA believes that an arbitrary numeric investment cap is an ineffective test for investor suitability. Each investor's financial situation is unique and suitability may differ for investors of the same net worth according to an investor's age, education, investment experience, risk tolerance, investment objectives, or other investments, among various other factors. NASD has comprehensive suitability rules, prohibiting broker-dealers from participating in a public offering of a DPP unless suitability standards have been established by the program and are fully disclosed in the prospectus. NASD requires its members in recommending an interest in a DPP:

> [To] have reasonable grounds to believe, on the basis of information obtained from the participant concerning his investment objectives, other investments, financial situation and needs, and any other information known by the member or associated person, that:
>
> a) the participant is or will be in a financial position appropriate to enable him to realize to a significant extent the benefits described in the prospectus, including the tax benefits where they are a significant aspect of the program;
>
> b) the participant has a fair market net worth sufficient to sustain the risks inherent in the program, including loss of investment and lack of liquidity; and
>
> c) the program is otherwise suitable for the participant.[2]

NASD also requires broker-dealers to maintain documents disclosing the basis upon which suitability was determined. Finally, broker-dealers have a fundamental responsibility of fair dealing with customers, including determining whether a reasonable basis exists for engaging in the DPP transaction and the fairness of the recommended price for the purchase or sale. MFA believes that these requirements, rather than an inflexible investment maximum, more appropriately address an individual investor's needs and investment suitability.[3]

---

[2] NASD Rule 2810.

[3] MFA would also like to point out that a broker-dealer selling interests in a public commodity pool is registered with the SEC, a member of the NASD, as well as registered or licensed in states in which it conducts business. A broker-dealer has a strong interest in complying with the NASD's suitability requirements for the long-term interest of its business, since failure to comply would subject it to disciplinary action, including revocation, suspension or cancellation of its registration or license, as well as jeopardize its long-term customer relationships.

B) The Proposed Clause is Ambiguous.

MFA is concerned that the proposed phrase "The maximum investment in the PROGRAM and AFFILIATES and other investments with similar investment objectives" is ambiguous and vague. As written, the proposed phrase presumably would include stocks and bonds of publicly-held affiliates, which present different risk considerations, in calculating an investment maximum in a public pool. Such a calculation would further limit an investor's ability to invest in a public pool and diversify his or her investments. For example, if an investor owned stocks and bonds, equivalent to eight percent of his net worth, of a parent company, he would then be restricted from purchasing interests in an affiliated company's public pools totaling more than two percent of his net worth. We believe this outcome to be overly restrictive. The proposed clause limits an investor from diversifying for reasons unrelated to the risk considerations of the actual investment product. It is also unclear as to what would constitute a "similar investment objective." We are concerned that such a requirement is overly broad and fails to consider important factors, such as the particular managers, investment strategies, fees, and structures of the investment vehicles.

C) The Proposed Clause would lead to Unintended Outcomes.

In addition, a potential unintended outcome of a 10% investment maximum restriction is that such a restriction may push investors who reach the maximum into private investment asset classes in order to achieve further diversification and higher investment returns. This outcome seems illogical and contrary to the Project Group's intent in proposing an investment maximum and to the advice that public funds provide the best access to futures investments for all but the most sophisticated investors.

D) The Proposed Clause would be Inefficient and Expensive.

Finally, we are concerned that the proposed revision to establish a 10% investment maximum will be very difficult and costly, if not impractical, to administer. The challenge that issuers and broker-dealers would face with such a restriction would be in documenting and proving to regulators, such as the NASD and state securities regulators, that they are in compliance with the investment maximum. Regulators have indicated that an issuer or broker-dealer cannot rely on the representation of an investor or subscription document to satisfy suitability requirements. Accordingly, an issuer would have to provide documentation of an investor's financial accounts, including those located at other financial institutions, to show net worth and compliance with the 10% investment maximum in "investments with similar investment objectives."

From our experience, investors in public pools, generally, have several investment accounts at different firms, and various banking accounts. We are concerned that clients may find such a requirement to be overly-intrusive and would be reluctant to provide documentation for all of their financial accounts or copies of account statements to show continual compliance with the investment maximum. The practical effect may be that

investors will be limited to investing only 10% of their assets at a particular broker-dealer in a public pool, or other DPP. We are also concerned that the cost associated with administering such a documentation system would in some cases make it impractical to offer interests in a public pool. We believe the 10% investment maximum, ultimately, would impede investors from properly diversifying and limit their investment options.

MFA believes suitability is inherently a subjective test and that an arbitrary quantitative test would be of limited utility. We also believe that the proposed revision is ambiguous, would lead to unintended outcomes, and would be inefficient and expensive to administer. For the reasons discussed, MFA respectfully requests the Project Group not adopt a maximum investment restriction. Nevertheless, if the Project Group considers it necessary to adopt some sort of quantitative guideline, MFA respectfully requests the Project Group consider adopting it as a recommendation rather than a strict requirement. MFA also respectfully requests that should the Project Group adopt a maximum investment requirement or recommendation, that it provide guidance regarding compliance and enforcement of such a clause.

* * *

We appreciate this opportunity to comment on the proposed revisions to the NASAA statement of policy on the registration of commodity pool programs and we would be happy to discuss any questions the Project Group may have with respect to this letter. Please feel free to reach me at 202.367.1140.

Very truly yours,

John G. Gaine
President

cc: Deborah House, Director of Policy, NASAA