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April 12, 2011

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 76 Fed. Reg. 7976 (Feb. 11, 2011) (the "Release")

Dear Mr. Stawick:

We appreciate the Commodity Futures Trading Commission ("CFTC") providing us with the opportunity to comment on the proposed amendments to Rule 4.13 of the regulations promulgated by the CFTC under the Commodity Exchange Act, as amended (the "CEA").[1] While the Release contemplates several significant amendments, this letter focuses on the proposed rescission of Rules 4.13(a)(3) and 4.13(a)(4) (the "Proposed Amendments").[2] The Release states that the CFTC is proposing to adopt the Proposed Amendments to insure that there is adequate transparency as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[3] While we understand the CFTC's concern with transparency in markets, we believe that the Proposed Amendments will cause many advisers to hedge funds who are (or, as a consequence of the Dodd-Frank Act, will be) registered as investment advisers under the Investment Advisers Act of 1940, as amended (the "Advisers Act"),[4] to be subject to dual registration with the Securities and Exchange Commission ("SEC") and the CFTC, notwithstanding that they are primarily advising with respect to securities and

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[1] 17 C.F.R. § 4.13 (2011).

[2] Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 76 Fed. Reg. 7976, 7985 (Feb. 11, 2011) (to be codified at 17 C.F.R. pts. 4, 145, 147) [hereinafter The Release].

[3] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) [hereinafter The Dodd-Frank Act].

[4] Investment Advisers Act of 1940, 15 U.S.C. § 80b-3(b) (2010).

that such dual registration and regulation is at odds with the language and intent of both the Advisers Act and the CEA. Congress, in approving the Dodd-Frank Act, specifically approved a statutory scheme in which such dual registration and regulation was to be avoided.

Accordingly, we recommend that: (i) Rules 4.13(a)(3) and 4.13(a)(4) remain unchanged; (ii) should the CFTC adopt the Proposed Amendments, they should be modified to provide that, where an investment adviser is registered with the SEC and exempt from registration as a commodity trading adviser ("CTA") because it is primarily advising with respect to securities, such adviser and its affiliates (typically the general partners of funds advised by the adviser) should also be exempt from registering as commodity pool operators ("CPOs"); (iii) if neither of the foregoing recommendations are adopted, existing advisers should be permitted to continue to rely on Rules 4.13(a)(3) and 4.13(a)(4); (iv) independent of recommendations (ii) and (iii), a *de minimis* standard should be established for advisers that trade a relatively small amount of commodity interests; and (v) if the CFTC elects to rescind Rules 4.13(a)(3) and 4.13(a)(4) in part or in whole, existing advisers should have at least 18 months to comply with the amended regulations.[5]

I. No Rescission of the Rule 4.13(a)(3) and 4.13(a)(4) Exemptions is Necessary

We are a law firm which represents many private investment funds, including hedge funds and private equity funds, the investment advisers to such funds and the general partners of such funds. In general, the investment adviser and the general partner are affiliated entities. With few exceptions, the general partners and, in many instances, the investment advisers rely on either Rule 4.13(a)(3) or Rule 4.13(a)(4) to exempt them from registration as CPOs and CTAs. These fund advisers, and their general partners, have been primarily engaged in rendering securities advice. Some have been registered as investment advisers with the SEC and, as a result of the Dodd-Frank Act, many more will be required to register as investment advisers. Under the Dodd-Frank Act, the private adviser exemption from registration under the Advisers Act will no longer exist (effective July 21, 2011). Advisers that are primarily engaged in securities related advisory activities and have more than $100 million in assets under management will be, subject to certain exemptions, required to register with the SEC as investment advisers pursuant to the Dodd-Frank Act. We recommend that, for advisers who are (or who will be) registered with the SEC, the exemptions from registration as CPOs under Rules 4.13(a)(3) and 4.13(a)(4) are consistent with avoiding duplicative regulation and should not be rescinded.[6]

[5] Additionally, we recommend that the CFTC consider whether it would be appropriate and consistent with sound public policy to exempt from registration as CTAs: advisers of venture capital funds; advisers of small business investment companies; advisers to private funds who have less than $150 million under management in the U.S.; mid-sized private fund advisers; family offices and foreign private advisers. Each of the foregoing groups is expressly carved out from registration as an investment adviser with the SEC. *See* The Dodd-Frank Act, *supra* note 3, at §§ 403, 407, 408 and 409.

[6] If a pool is trading primarily commodity interests, we understand the regulatory arbitrage concerns outlined by the CFTC in the Release. We believe, however, that the Proposed Amendments can and should be crafted in a manner that addresses those concerns without subjecting large groups of advisers to duplicative regulation.

II. Registration of Currently Exempt Advisers as CPOs

Under Section 4m(3) of the CEA, an adviser is exempt from CTA registration if it is registered with the SEC as an investment adviser, its business does not consist primarily of acting as a CTA and it does not act as a CTA to an investment trust, syndicate or similar form of enterprise that is primarily engaged in trading in a commodity for future delivery on, or subject to the rules of, a contract market or registered derivatives transaction execution facility.[7] Even if the Proposed Amendments were adopted, advisers would still be exempt from registration as CTAs (assuming they meet the criteria of Section 4m(3)), but they (or their affiliates) would not be exempt from registration as CPOs. As a CPO, an adviser (or its affiliates), which is already registered with the SEC, will need to register with, and report to, the CFTC and submit to examination by the National Futures Association ("NFA"). We believe, as noted above, that this result runs contrary to the logic of the Advisers Act and the CEA and contradicts one of the premises of the Dodd-Frank Act: improve transparency for investors while avoiding duplicative and unduly burdensome regulation. Indeed, exempting CPOs from registration under these circumstances would further at least two of the Proposed Amendments' stated goals: encouraging more "congruent and consistent regulation" of similarly-situated entities among regulatory agencies; and aligning the CFTC's regulatory structure with the stated purpose of the Dodd-Frank Act.[8]

Support for a CPO exemption can be found in both the Dodd-Frank Act and the Release. Before the Dodd-Frank Act was passed, Section 203(b)(6) of the Advisers Act provided that "[a]ny investment adviser that is registered with the [CFTC] as a [CTA] whose business does not consist primarily of acting as an investment adviser, as defined [under the Advisers Act] . . ." need not register with the SEC.[9] Section 403 of the Dodd-Frank Act amended Section 203(b)(6) of the Advisers Act but kept intact the concept that "[a]ny investment adviser that is registered with the [CFTC] as a [CTA] and advises a private fund" need only register with the SEC if "after the date of enactment of the [Dodd-Frank Act], the business of the advisor should become predominately the provision of securities-related advice . . . ."[10] The Senate and House had discussed requiring dual registration of such advisers, and the outcome of that discussion was that dual registration was rejected.[11] The compromise by the Senate and the House became Section 203(b)(6)(B). Congress concluded that the CFTC was able to regulate advisers that are registered with the CFTC and primarily trade commodity interests without additional regulation by the SEC. Using the same analysis, it seems that the corollary should

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[7] Commodity Exchange Act, 7 U.S.C. § 6m(3) (2010).

[8] The Release, *supra* note 2, at 7978.

[9] 15 U.S.C. § 80b-3(b)(6).

[10] The Dodd-Frank Act, *supra* note 3, at § 403.

[11] *See Wall Street Reform and Consumer Protection Act: Hearing before the H. and S. Conf. Comm.*, 111th Cong. 90 (2010) [hereinafter *The Hearing*] ("I'd say to my colleagues here that we've -- we've been approached by our Senate conferees from the Ag Committee, and they've asked that the initial counteroffer position on the first House item regarding registration with the SEC of commodity trading advisers is to reject this, to avoid the duplicative regulation. And we're going to accommodate them on that request." (statement of Sen. Chris Dodd)).

also be true: if an adviser is regulated by the SEC and primarily trades securities, the SEC can and should regulate such advisers without additional regulation by the CFTC.

In the Release, the CFTC notes that "[it] has determined that it is appropriate to limit regulatory arbitrage through harmonization of the scope of its data collection with respect to pools that are similarly situated to private funds so that operators of such pools will not be able to avoid oversight by *either* the [CFTC] *or* the SEC through claims of exemption under the [CFTC]'s regulations."[12] However, if CPO registration is not required where an adviser is registered with the SEC as an investment adviser, the CFTC's goal of regulation by either the CFTC or the SEC would be achieved. The legislative history of the Dodd-Frank Act also supports the idea of regulation by either the CFTC or the SEC, as evidenced by Senator Jack Reed's statement during the House-Senate Conference Committee that "by incorporating hedge fund registration and private equity registration in the Investment Adviser Act . . . the SEC will . . . pick up many [commodity interests-related] activities . . . ."[13]

Furthermore, if currently exempt advisers (or their affiliates) are required to register as CPOs with, and consequently report to, the CFTC, and be subject to examination by the NFA, the Proposed Amendments are likely to impose significant reporting costs on advisers. We suggest that this second layer of regulatory costs due to dual registration for the same activities is not warranted. To the extent that the Dodd-Frank Act is concerned with systemic risk issues, the SEC and the CFTC have already jointly proposed significant reporting requirements to permit the early detection of systemic risk issues and all investment advisers registered with the SEC will be subject to some reporting on Form PF, as it is proposed.[14] Moreover, the CFTC already has reporting and oversight mechanisms in place with respect to exempt advisers. For example:

1. under Rule 4.13, an exempt adviser must file a notice with the NFA that includes its name and address and lists any commodity pool it operates under a CPO exemption.[15] The exempt adviser must make and keep all books and records prepared in connection with its activities as a CPO for a period of five years from the date of preparation and also ensure that those books and records are accessible for the first two years of that five-year period.[16] Furthermore, these books and records must be available for inspection upon the request of any representative of the CFTC, the Department of Justice or any other appropriate regulatory agency;[17]

[12] The Release, *supra* note 2, at 7986 (emphasis added).

[13] *The Hearing*, *supra* note 10 (statement of Sen. Jack Reed).

[14] *See* CFTC Release No. 3038 and SEC Release No. 3145 (Jan. 26, 2011).

[15] 17 C.F.R. § 4.13(b)(1)(i).

[16] *Id.* at (c)(1)(i)-(ii).

[17] *Id.* at (c)(1)(ii).

2. exempt advisers must submit to special calls that the CFTC may make to demonstrate eligibility for, and compliance with, the applicable criteria for exemption;[18]

3. exempt advisers are subject to the prohibition on fraudulent transactions under Section 4o of the CEA;[19] and

4. exempt advisers are subject to the CFTC's and various futures exchanges' position limits, as well as the CFTC's reportable position requirements.[20] Any exempt adviser that holds or controls a reportable position must fill out CFTC Form 40, which requires the adviser to provide *inter alia* information about its business, brokers, underlying pools, beneficial holders and commodity interests trading activity.[21]

In sum, we believe that a parallel CPO exemption that complements the CTA exemption would bring symmetry to the way in which the SEC and the CFTC administer their registration and regulatory regimes.

III. "Grandfathering" Provision

As noted above, we recommend that the CFTC retain Rules 4.13(a)(3) and 4.13(a)(4) as they currently exist or, in the alternative, adopt a different approach that exempts CPOs from registration where their affiliated CTA is registered with the SEC as an investment adviser. One of the many advantages of this approach is that it would treat existing and new advisers alike. Nevertheless, should the CFTC determine to not take either approach, we recommend that the CFTC grandfather all advisers (and their affiliates) that have previously claimed an exemption under Rules 4.13(a)(3) and 4.13(a)(4) and allow those advisers to remain exempt from registration. We respectfully ask the CFTC to provide greater detail on how any grandfathering provision it adopts will operate (e.g., would a grandfathered advisor be able to admit new investors or launch new products).

IV. *De Minimis* Exemption

The Release requests comment on whether the CFTC should consider an alternative *de minimis* exemption under Rule 4.13, and if so, what criteria should be required to claim such an exemption. Presently, Rule 4.13(a)(3) provides an exemption from CPO registration for an adviser whose fund is (1) offered to accredited investors and (2) meets a *de minimis* test that ensures that its commodity interest exposure does not exceed either (a) 5 percent of the liquidation value of the fund (measured by including the fund's initial margin and premiums to establish the commodity interest positions) or (b) 100 percent of the fund portfolio's

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[18] *Id.* at (c)(1)(iii).

[19] 7 U.S.C. § 6o.

[20] *See* 17 C.F.R. §§ 18.00–18.05.

[21] 17 C.F.R. § 18.04.

liquidation value (measured by including the net notional value of the fund's commodity interest positions).[22] It is our view that a *de minimis* exemption should remain in place independent of the acceptance or rejection of our proposed parallel CPO exemption (discussed above in section II) and grandfather provision (discussed above in section III). The existing Rule 4.13(a)(3) test could work well as a starting point for the CFTC's analysis. Moreover, because swaps are to be considered commodity interests under the Dodd-Frank Act,[23] any proposed *de minimis* exemption should include a parallel threshold that would exempt *de minimis* swaps contracting activity. Considering the foregoing, we believe that the economic burden of requiring advisers that trade a relatively small number of commodity interests will outweigh the benefit of their registration.

V. Transition Period

The Release requests comment on how much time is necessary for entities that have previously claimed an exemption under Rules 4.13(a)(3) and 4.13(a)(4) to comply with the Proposed Amendments.

If the Proposed Amendments are adopted in their current form, many advisers will be required to register with the CFTC as CPOs and become members of the NFA. Registration will require these advisers to determine which of their personnel are "associated persons" subject to licensing. Assuming they are not entitled to relief under CFTC rules, each associated person will then need to be fingerprinted, sit for and pass the applicable proficiency examination, undergo the registration process and prepare compliant disclosure documents.[24] Given these requirements, we recommend that advisers should have at least 18 months from the Proposed Amendments' adoption date to comply with the new requirements.[25]

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[22] 17 C.F.R. § 4.13(a)(3).

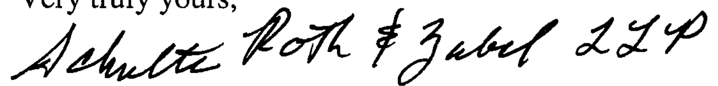
[23] The Dodd-Frank Act, *supra* note, 2 at § 721.

[24] NFA: Registration for Associated Persons, http://www.nfa.futures.org/nfa-registration/ap/index.HTML (last visited Apr. 11, 2011).

[25] Under the Dodd-Frank Act, advisers were effectively given one year to register with the SEC, and the SEC staff recently commented: "we expect that the Commission will consider extending the date by which . . . [unregistered] advisers must register and come into compliance with the obligations of a registered adviser until the first quarter of 2012." Letter from Robert E. Plaze, Associate Director, SEC Division of Investment Management, to David Massey, Deputy Securities Administrator, North Carolina Securities Division, and President, North American Securities Administrators Association, Inc. (April 8, 2011) *available at* http://www.sec.gov/rules/proposed/2010/ia-3110-letter-to-nasaa.pdf.

We respectfully submit our comments with the objective of assisting the CFTC in further refining the Proposed Amendments and in pursuing its goals with respect to private investment funds. We would be pleased to discuss any aspect of this letter with you and other members of the CFTC. Please direct any questions that you may have to Paul N. Roth at (212) 756-2450 or Daniel F. Hunter at (212) 756-2201.

Very truly yours,



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