

July 20, 2007

Via E-mail (pubcom@nasd.com)

Ms. Barbara Z. Sweeney  
Office of the Corporate Secretary  
NASD  
1735 K Street, NW  
Washington, DC 20006-1506

Re: Proposed Rule 2721; Member Private Offerings

Dear Ms. Sweeney:

National Futures Association (NFA) appreciates the opportunity to comment on proposed NASD Rule 2721. As a registered futures association under the Commodity Exchange Act (CEA) and a self-regulatory organization for the futures industry, one of NFA's responsibilities is to oversee the regulatory requirements for registered commodity pool operators (CPOs) and their regulated commodity pools. Proposed Rule 2721 would result in duplicative regulatory requirements for these entities. Therefore, we respectfully request that NASD exempt regulated commodity pools from its proposed requirements.

Theoretically, any collective investment vehicle that trades one futures contract is a commodity pool and its operator is a CPO governed by the CEA.<sup>1</sup> The Commodity Futures Trading Commission (CFTC), has, however, created a number of exclusions and exemptions by rule. CFTC Regulation 4.5 excludes certain otherwise regulated entities (e.g., registered investment companies) from the very definition of commodity pool operator, taking them outside of the CEA's reach. CFTC Regulation 4.13 exempts CPOs who operate pools meeting various criteria (e.g., sophisticated investors, limited futures activity) from the CEA's registration requirements, which means that the entities operating these pools are subject only to the CEA's antifraud provisions for their conduct relating to those pools.

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<sup>1</sup> The CEA and CFTC rules reach collective investment vehicles indirectly by imposing registration and other requirements on the entities operating those vehicles. Since the operator makes legal and operational decisions and has the authority to act on the pool's behalf, this is an effective regulatory scheme.

Non-exempt pools are subject to the CEA's registration requirements and to CFTC and NFA rules. Except for Rule 4.7 pools (discussed below), these rules require the CPO to prepare a written disclosure document, to file the document (and any amendments) with NFA at least 21 days before its first use, to distribute the document to participants along with (or prior to) the subscription agreement, and to provide participants with any material amendments. The disclosure document must contain a wide variety of required information, including:

- A prescribed risk disclosure statement, plus a discussion of the principal risk factors for the particular pool;
- The pool's investment program and use of proceeds;
- A description of all fees and expenses to be incurred by the pool, including a break-even table that includes incentive fees, trail commissions, brokerage fees, and organizational and offering expenses; and
- Any other information necessary to ensure that the document is not misleading.

NFA reviews each disclosure document filed with NFA, including those voluntarily prepared and filed by 4.7 pools. NFA's review is designed to ensure that the documents include all necessary information and that the investing public receives adequate disclosure about the investments being offered. If we have concerns regarding inadequate or misleading disclosure, we require the CPO to revise the disclosure document before using it. In the past year, NFA has reviewed disclosure documents from 47 public commodity pools, 13 Rule 4.7 pools, and 323 pools that are not required to register their securities with the SEC but do not qualify for Rule 4.7 relief.

All pools must provide participants with year-end financial statements and must file those statements with NFA. NFA analyzes each one of these statements, most within 30 days of receipt. This review examines whether the financial statement adequately reflects the pool's assets and liabilities and is consistent with any disclosure document on file, and it focuses special attention on unusual balances and significant changes in the pool's net asset value. NFA looks at the pool's entire financial statement, with the greatest emphasis on the pool's futures activities.

NFA has a number of programs to monitor CPOs' compliance with applicable rules and regulations. NFA's on-site examinations provide the most comprehensive review. During these examinations, NFA staff looks for and reviews transactions between the CPO and its pools, transfers between the CPO's pools, and the CPO's banking relationships. Staff performs basic testing on all the commodity pools operated by the CPO, including reviewing the pools' participant lists, solicitation materials, additions, and withdrawals. In addition, NFA uses a risk-based approach to select and test one pool in detail. In choosing this pool, NFA considers a number of factors, including the number of participants in the pool, the pool's total net asset value, exemptions held by the pool, and whether NFA conducted detailed testing on the pool in

a prior exam. NFA reviews the pool's financial records, including its assets and liabilities, with an emphasis on the pool's futures transactions, and NFA confirms the existence of non-futures assets—including securities, cash, swaps, and other financial instruments—that have a material effect on the pool. NFA also reviews the pool's trading activity for consistency with its disclosure document or offering memorandum.

NFA currently examines approximately 300 CPOs every year. CPOs are generally examined within 3 years after becoming active and every 3-4 years thereafter. Under NFA's risk-based approach, we examine CPOs more frequently when we have reason to believe that a CPO or any of its pools poses undue risks.

Rule 4.7 pools, which have more sophisticated participants, are exempt from some of the CFTC's recordkeeping and disclosure requirements but must provide participants with quarterly net asset information and with an annual report containing financial information about the pool and must file the annual report with NFA. Although they are not required to provide a disclosure document or private placement memorandum, we have noted during the course of our examinations that most of them use a private placement memorandum that includes the full list of disclosures required for other regulated pools. Furthermore, CFTC Regulation 4.7(b)(1) provides that an offering memorandum used to solicit participants must include any disclosures necessary to ensure that the information it contains is not misleading.

As you can see, commodity pools that are not excluded or exempt under CFTC Rules 4.5 or 4.13 are already subject to a comprehensive regulatory regime. Therefore, we respectfully ask NASD to treat commodity pools similar to the offerings identified in Proposed Rule 2721(e) and carve them out of its proposed requirements.

Thank you for the opportunity to comment on the proposal. If you have any questions, or if we can be of any further assistance, you can contact me by e-mail at [tsexton@nfa.futures.org](mailto:tsexton@nfa.futures.org) or by telephone at 312-781-1413.

Very truly yours,

Thomas W. Sexton  
Vice President & General Counsel

(kpc/CPOCTA Issues/NASD Private Offerings, Comment Letter)