



# The Association of the Bar of the City of New York

## Committee on Futures Regulation

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### **BY HAND DELIVERY**

October 7, 2004

Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, DC 20549-0609  
Attention: Mr. Jonathan G. Katz, Secretary

**Re: Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the NASD Relating to the Implementation Date of Notice to Members 04-50 (Treatment of Commodity Pool Trail Commissions under Rule 2810) Release No. 34-50335; File No. SR-NASD-2004-136 (the "Release")**

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Ladies and Gentlemen:

The Committee on Futures Regulation (the "Committee") of the Association of the Bar of the City of New York (the "Association") is pleased to submit the following comments on the Release, which was published in the Federal Register at *69 Fed. Reg. 55855* (September 16, 2004).

The Association is an organization of over 22,000 lawyers. Most of its members practice in the New York City area. However, the Association also has members in nearly every state and over 50 countries. The Committee consists of attorneys knowledgeable in the regulation of futures contracts and other derivative instruments and it has a history of

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publishing reports analyzing regulatory issues critical to the futures industry and related activities, including those affecting the sponsors and operators of publicly offered funds, their advisors and brokers. The Committee appreciates the opportunity to comment on the Release and stands ready to assist the Commission and its staff if further clarification is required on any of the points raised in this letter.

The Release seeks comments on the NASD's rescission of its "policy" that has permitted, for nearly 25 years, the payment of trail commissions in publicly offered commodity pools without treating such payments as selling compensation subject to the 10% cap on underwriting compensation generally applicable to direct participation programs ("DPPs") under NASD Rule 2810. Trail commissions are compensation for ongoing commodity-related services paid to CFTC-regulated brokers who place interests in publicly offered commodity pools. The Committee submitted (i) a letter to the NASD, dated March 12, 2004 (the "March Letter"), in response to NASD's request for comments on this matter and (ii) a letter to the Commission, dated August 20, 2004 (the "August Letter," and together with the March Letter, the "Letters"), in response to the NASD's Notice of Filing and Immediate Effectiveness published on July 30, 2004. The Letters, copies of which are attached, included questions and requested clarification so that the consequences of any change in the long-standing policy could be adequately assessed. Our questions have not been adequately addressed. Therefore, we reiterate each of the points made in the Letters including our belief that the proposed "change in policy" is in reality a rule change. In the Committee's opinion, prior to its becoming effective the proposed change should be subject to the notice and comment period requirements of Section 19(b)(1) of the Securities Exchange Act of 1934 with respect to self-regulatory organization rule changes.

In response to comments received, including the August Letter, the NASD submitted a letter to the Commission on August 30, 2004. In that letter, the NASD referred to comments received from the Committee, stating in Footnote 1 that while the August Letter called for abrogation, the March Letter did not oppose the NASD's proposal on specific substantive grounds. We note that the March Letter sought clarification so that meaningful comment could be given. That letter requested that the NASD clarify the basis upon which it was proposing to change its long-standing position and the procedure it was advocating to effect that change. Having understood the NASD's position that NtM 04-50 does not amend any text of Rule 2810 or amend any published statements of the NASD, the Committee concluded and commented in its August 20 letter that the NASD was not pursuing the right process and that the change in policy was tantamount to a rule change subject to the notice and comment period requirements of Section 19(b)(1) of the Exchange Act.

We acknowledge that in response to these and other concerns expressed in the various comment letters referred to in the NASD's letter, the NASD has delayed effectiveness of the change to October 12, 2004. While this addresses the concerns of the commodity

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pools in registration on July 13, 2004, the postponement of effectiveness does not address our fundamental concern that the rule change may adversely affect the market for public commodity pools. These pools are fundamentally different from other DPPs and also differ in some respects from commodity managed accounts, the primary alternative to commodity pools available to investors. Unlike such accounts, investors in commodity pools are not subject to unlimited losses. Public commodity pools are one of the few limited liability diversification tools available to retail investors. In addition, Series 3 and 31 registered representatives provide ongoing guidance to investors in commodity pools, which is not available to investors in many other DPPs.

One unintended effect of the changed policy might be that successful pools will decide not to increase the size of their offerings because the broker selling the pool would have to obtain a new "no objections" opinion from the NASD in order to register new units for sale and those new units presumably would be subject to the limitation on the payment of trail commissions. As we noted before, pools typically offer a single class of units for sale at a single net asset value per unit. The accounting complexities involved in having units within the same pool subject to different restrictions would likely make increasing the size of the offering of existing pools an undesirable alternative. Without clarification on this point, a commodity pool sponsor is not likely to go to the expense of attempting to register new units in an existing pool.

As noted in our prior letters and as the Commission knows, operators of commodity pools are subject to substantial regulation by the Commodity Futures Trading Commission under the Commodity Exchange Act. Each investor in a public commodity pool must acknowledge receipt of a disclosure document and prospectus that details, among other things, all of the fees to which the pool will be subject. Public commodity pools provide access to futures and other derivatives markets to investors who often would not have access to those markets because they would not be eligible for individually managed accounts. The change in the treatment of trail commissions in public commodity pools may, in effect, result in unnecessarily different treatment of investors in the commodity futures markets.

The Committee stands ready to assist the Commission with further information or other assistance regarding this important matter.

Very truly yours,

*Rita M. Molesworth /s.k.s.*

Rita M. Molesworth

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- \* Member of Subcommittee that drafted this letter of comments.  
 \*\* Chair of Subcommittee that drafted this letter of comments.

Adjunct Members

Joyce M. Hansen  
 Cindy Ma  
 Stephen J. Obie  
 Michael Piracci  
 Lore Steinhauser Φ

ΦMs. Steinhauser and Ms. Dow abstained from participating in this letter of comments.