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Ms. Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street, N.W.
Washington, D.C. 20006-1500

Re: NASD Notice 04-07: Regulation of Compensation, Fees, and Expenses in Public Offerings of Real Estate Investment Trusts; Direct Participation Programs, including Commodity Pools and Closed-End Funds

Dear Ms. Sweeney:

Citigroup Managed Futures LLC ("CMF") and Citigroup Global Markets Inc. ("CGMI") are pleased to provide these comments with regard to commodity trail commissions paid by commodity pools as requested in NASD Notice 04-07 (February 2004) (the "Notice"). In the Notice, the NASD proposes rescinding its interpretation of NASD Rule 2810 with respect to payments of "commodity trail commissions" by publicly offered commodity pools. "Commodity trail commissions" for purposes of this letter are the amounts paid by CGMI to its CFTC-registered associated persons as compensation for services to investors, which amounts are a portion of the commodity brokerage commissions paid by a publicly offered commodity pool to CGMI. Since 1982, commodity trail commissions have been excluded from the limitations on sales compensation in NASD Rule 2810.

CMF is a commodity pool operator ("CPO") and commodity trading advisor ("CTA") registered with the Commodity Futures Trading Commission ("CFTC") in order to operate commodity pools. Currently, CMF operates 7 publicly offered commodity pools ("Pools") and 16 privately offered pools. Over the last 25 years, CMF (or a predecessor firm) has operated approximately 50 publicly and privately offered pools. CGMI (or a predecessor firm) acts or acted as futures commission merchant ("FCM") and selling agent for each of the Pools and privately offered pools operated by CMF. As of February 29, 2004, CMF Pools in the aggregate have approximately 28,000 investors and net assets of approximately $939,000,000.

This letter (i) demonstrates that payment of commodity trail commissions by CGMI is justified by the quality and level of service provided to investors and that rescinding the NASD's trail commission policy could have adverse effects on the Pools and their investors and (ii) concludes that commodity trail commissions are not sales compensation and so, consistent with the NASD's policy of over 20 years, should not be limited by NASD Rule 2810.

Commodity pools in the United States grew out of a need to provide retail investors with access to the commodities markets in a vehicle that limits potential liability (e.g., a limited partnership) and provides professional management. Over their history, commodity pools have evolved from total absolute return vehicles into alternative investments designed not only to achieve total absolute return, but also to provide diversification from traditional portfolios of stocks and bonds. Today, commodity pools are among the few alternative investments available to retail investors that provide a diversified asset class to complement an existing traditional portfolio. It should be noted that during the entire history of commodity pools in the United States, the National Futures Association ("NFA"), self-regulatory organization for the commodities industry, has found no instances of abuse related to publicly offered commodity pools generally or commodity trail commissions specifically.

A. Justifying Commodity Trail Commissions.

1. *Trails paid by CGMI are a portion of commodity brokerage commissions paid for commodity-related services; trails are not sales compensation within NASD Rule 2810.* The structures in which commodity trail commissions are paid vary among commodity pools and CPOs. With respect to pools operated by CMF, each Pool deposits its funds in commodity brokerage accounts at CGMI, its FCM, for execution and clearing of futures and options on futures transactions. Pools pay CGMI a monthly brokerage commission based on month-end net assets of the Pool in return for the services provided by a full service commodity broker. These commodity brokerage commissions are the only fees paid to CGMI or CMF by the Pool. Commodity trail commissions are a portion of these commodity brokerage commissions paid by CGMI as FCM to its associated persons who provide ongoing services to commodity pool participants related to the operation of the Pool. Those services are described below in item 3. Thus, neither the commodity brokerage commissions paid by a Pool nor the portion of those commissions paid to associated persons are sales compensation within NASD Rule 2810.

2. *Trails are not up-front selling commissions.* Commodity trail commissions are a portion of the commodity brokerage commissions generated by a Pool. Commodity trail commissions are not an up-front charge subtracted from an investor's subscription amount. 100% of an investor's subscription amount is deposited in the Pool's commodity brokerage accounts at CGMI. Commodity brokerage commissions charged by CGMI are in a "customary" range (i.e. between institutional rates and "published public customer rates") and are competitive with rates charged to comparable pools by other FCMs. For example, in the most recently offered CGMI Pool, commodity brokerage commissions equal 5.5% of net assets per year, which equates to $22 per round-turn transaction based on the Pool's trading history. Approximately 32% of the commodity brokerage commissions paid by the Pool (or 1.76% of net assets) are paid as net trail commission to associated persons. Therefore, the payment of commodity trail commissions adds no additional cost to the brokerage commissions charged to the Pool; the commission rate charged to a Pool would be the same whether CGMI retains 100% of the brokerage commissions charged to the Pool or pays a portion of them to its associated persons.

3. *Commodity trail commissions are payment for commodity-related services.* Associated Persons of CGMI provide a variety of ongoing services to investors in return for commodity trail commissions. The services include (a) responding to inquiries from investors about the value of units; (b) providing information and responding to inquiries about the commodities markets and the pool'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 because pools

generally have monthly liquidity; (d) assisting investors in redeeming units; and (f) providing other services requested from time to time by investors.

These services differ from and are more complex than services provided by a registered representative in connection with an exchange-listed stock offering, investment companies or various other limited partnership offerings as a result of the nature of commodity pools and the commodity markets in which they invest.

- Pools offer monthly redemptions over the life of the Pool as well as monthly subscriptions until maximum offering amounts are reached.
- Pools are required to maintain daily net asset values and to report specific financial information to investors at least monthly.
- Pools often hold positions in over 100 different commodity futures markets.
- Those positions may turn over on a daily basis.
- Commodity markets may not move in parallel with each other or with the stock and bond markets.
- Commodity market trends are not regularly highlighted on the nightly news or in other general media.
- CTAs have varying trading strategies and styles, and Pools often have multiple CTAs.

As a result of all of these facts, in order to service Pool investors, associated persons must have significant knowledge with respect to the commodity markets in general and the CTAs in a Pool, as well as access and the ability to interpret daily data related to the Pool.

Thus, commodity trail commissions are a portion of the commodity brokerage commissions paid by Pools for commodity-related services. Those services are different and more complex than those provided by registered representatives with respect to other products. Consequently, commodity trail commissions should not be considered as sales compensation under NASD Rule 2810.

4. *Trails Derive from Commodities Industry*. Commodity trail commissions developed from and are consistent with practices in the commodity futures industry related to servicing commodity customer accounts. Thus, the qualification requirements applicable to recipients of commodity trail commissions are similar to those applicable to individuals who limit their activities to commodity brokerage services. These practices have been recognized by the regulatory frame-work created under the Commodity Exchange Act.

5. *Regulatory Requirements for Associated Persons*. Commodity trail commissions are commodity-related compensation. This conclusion is underscored by the fact that those who receive trails must qualify to receive them by registering as associated persons

under the Commodity Exchange Act and must first pass either the Series 3 or the Series 31 examination. In addition to the testing requirement, as registrants under the Commodity Exchange Act, these individuals are subject to sanctions under the Act and related rules (including those of the NFA). Registrants are uniquely subject to periodic ethics training requirements.

6. *Separate Federal Regulator.* The regulatory requirements that apply to publicly offered commodity pools exceed considerably those that apply to other limited partnerships and other alternatives to investment in a traditional portfolio composed of stocks and bonds. Those products are not subject to a separate federal regulatory framework, such as the Commodity Exchange Act, applicable to all aspects of the operation of the product. Under the Commodity Exchange Act, the CFTC licenses and regulates the commodity futures markets as well as CPOs, CTAs, FCMs and their associated persons.

7. *All Fees and Expenses Including Trails are Disclosed.* All of the fees and expenses to be incurred by a Pool, including commodity trail commissions, are disclosed in its prospectus as required by the SEC, NASD, CFTC/NFA and the states. Disclosure includes the amount of commodity brokerage commissions and the portion of that amount paid as commodity trail commissions. Investors are also provided with a "break-even" table showing the impact of commissions and other expenses on potential trading profits. Finally, the potential conflict of interest for associated persons arising from their receipt of commodity trail commissions is prominently disclosed.

8. *State Regulation.* Many states substantively review prospectuses for public pools by application of the Guidelines for the Registration of Commodity Pool Programs of the North American Securities Administrators Association. Commodity trail commissions are acceptable under the Guidelines. The Guidelines also limit brokerage commissions that a pool may pay through establishing a level of commissions presumed to be reasonable. Brokerage rates must be disclosed and competitive. CGMI's brokerage rates are well below the limitation in the Guidelines.

Many states also impose investor suitability requirements (income and/or net worth - exclusive of home, furnishings and automobiles) on public pool participants. In contrast, states do not review the prospectuses of registered investment companies and almost anyone can purchase shares in them.

9. *Commodity Pools vs. Other DPPs.*

a. Liquidity. Most other programs that are direct participation programs are relatively illiquid, whereas commodity pools typically provide monthly redemption opportunities.

b. Trading Volume. In other programs, investments are often made once, at the beginning of operations (e.g., real estate or oil and gas investments), whereas commodity pools trade hundreds of contracts each day. Other programs do not provide daily net asset values and monthly financial reports, whereas CGMI Pools do.

c. *Non-Correlation.* Commodity pools serve an economic function for investors that other direct participation programs may not. Academic studies have shown that the addition of a non-correlated asset, like managed futures, to a traditional portfolio of stocks and bonds decreases volatility and increases return, provided that the managed futures portion of the portfolio is successful. Managed futures products in the form of the Pools are among the few non-correlated assets available to retail investors via public offerings.

B. **Effect of Rescinding NASD Policy.**

1. *Trail Commissions are Paid for Necessary Services.* If associated persons did not provide the above-described services to Pool investors, CMF as the Pool's general partner and CPO might have to outsource those services or create a separate infrastructure to provide those services to investors. Such other sources of services might well add substantial expense to the Pool and be less effective than associated persons are at doing what they are trained and qualified to do.

2 *CGMI's Trail "Model" Works.* The structure of CMF's Pools, including the payment of commodity trail commissions by CGMI to its associated persons, is beneficial to investors as well as to the associated persons involved. Investors receive the benefit of a limited liability investment, portfolio diversification and potential profit, as well as ongoing professional, educated assistance and advice from associated persons. These benefits are paid for by commodity brokerage commissions at competitive rates. Further, over the many years that CMF and its predecessors have operated commodity pools, no actions or complaints have been brought with respect to commodity trail commissions. Thus, the CMF/CGMI model is working well. Changes such as limitation on commodity trail commissions could have adverse effects on all involved.

C. **Conclusion**

The NASD's long-standing policy with respect to commodity trail commissions has excluded trails from the limitations of Rule 2810 for the reasons outlined in this letter. Commodity trail commissions are a portion of commodity brokerage commissions generated by Pools and paid to associated persons who provide a wide array of ongoing commodity-related services to investors in connection with this complex, otherwise regulated product. Commodity trail commissions were not and should not be considered sales compensation.

Thank you for the opportunity to comment on this important topic. We would be happy to meet with NASD staff at any time to discuss further the matters addressed in this letter or other matters relating to commodity trail commissions.

Very truly yours,

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