

instruments as part of their trading programs to reflect the performance of those instruments in their trading results. In the disclosure document review process and compliance audits, close attention would be paid to the description of the trading program and other documentation regarding the CTA's direction of income-producing instruments included in its performance record.

H. Range of Rates of Return for Closed Accounts

The Commission proposes to revise Rule 4.35(a)(1)(viii) to require that the performance capsule for the offered program include, in addition to the number of accounts closed with profits and the number closed with losses, the range of rates of return for the accounts closed with net lifetime profits and accounts closed with net lifetime losses, during the five-year period. The Commission believes that disclosing the range of rates of return for closed accounts in the offered program provides important summary information on the variation in returns experienced by individual clients and will be useful to prospective clients considering participation in the CTA's program. Because the draw-down information under the revised rules will be presented on a composite basis, presentation of the range of rates of return for closed accounts provides valuable information on the results experienced by individual clients.

The Commission notes that under the proposed rule amendments, both the numbers of accounts closed with positive versus negative rates of return, as well as the ranges of rates of return for accounts in each category, must be disclosed only for those accounts that both opened and closed within the required five-year and year-to-date time period. The Commission does not believe that this change will diminish the disclosure of material information to prospective clients, because of the tendency of clients to quickly close accounts that experience large losses. Accounts that experienced strongly negative returns before the five-year time period are likely to have been closed before the end of that time period, and losses experienced as a result of the offered program during the five-year period are likely to have been experienced by an account that both opened and closed during that period. The Commission wishes to make clear that any additional information that the CTA believes is necessary to explain the circumstances affecting the ranges of returns presented in the performance capsule may be provided, pursuant to

existing rules regarding supplemental disclosures and material information.³³

I. Treatment of Additions and Withdrawals in Computing Rate of Return

In proposing to amend Rule 4.35(a)(6)(i)(B), the Commission notes that CTAs would be permitted to choose, for their rate of return computation, one of the following three methods: (1) Net performance divided by beginning nominal account size; (2) daily compounded rate of return; or (3) net performance divided by the average weighted nominal account sizes for the month. These proposed changes would incorporate alternative methods of computing rate of return to account for intramonth additions and withdrawals, as permitted by the CFTC's 1991 Advisory.³⁴ The Commission is not proposing to include the Only Accounts Traded Method as an option CTAs may choose prospectively due to concerns that it allows for accounts to be excluded entirely from the rate of return computation. The Commission will, however, carefully consider proposals regarding any alternative method of addressing the effect of additions and withdrawals on the rate of return computation, whether as part of this rulemaking proposal or otherwise in the future.

The rule changes proposed herein would supersede applicability to CTAs of the CFTC's 1991 Advisory.³⁵ CTA performance computed in accordance with any of the alternative methods described in the 1991 Advisory for periods prior to the date upon which the rule changes proposed herein become effective, however, would not need to be revised. Because commodity pool performance may only be reported on the basis of actual funds, applicability of the 1991 Advisory to CPOs reporting commodity pool performance would be unchanged.

J. Disclosure of CTA Performance in CPO Disclosure Documents

The Commission is proposing changes to the presentation of CTA performance in CPO disclosure documents primarily to conform such presentation with the proposed revisions to Rule 4.35(a)(1). The Commission emphasizes that

narrative disclosure of the pool's allocations to its CTAs, as well as the use of leverage in determining such allocations, continues to be required pursuant to existing Rules 4.24(g) and 4.24(h).

III. Transitional Provisions

The Commission proposes to require CTAs and CPOs to comply with the revisions proposed herein, including the requirement to obtain the documentation required by new Rule 4.33(c) for both new and existing clients, by no later than the beginning of the calendar quarter that is at least 90 days after the date of publication of the final rules. The Commission seeks comment on any difficulties anticipated in complying with these proposed requirements by that date. CTAs and CPOs would be permitted to adopt these changes immediately upon the effective date of the final rules as adopted.

IV. Request for Comments Regarding a Core Principle Alternative

The Commission has received a number of requests from the managed funds industry that Commission policy pertaining to CTA disclosure of past performance to prospective clients be made consistent with the approach undertaken in the securities industry.³⁶ Under Federal securities laws there are no rules that mandate the manner in which investment advisers disclose past performance. Generally, investment advisers may present past performance in any manner that does not run afoul of general anti-fraud provisions.³⁷ It has been suggested that the Commission adopt a core principle in order to achieve parity with applicable securities laws and regulations as they relate to the disclosure of past performance made by CTAs to prospective clients.³⁸ Such a core principle would permit CTAs to present past performance to prospective clients in any manner they choose so long as such information is offered in a manner that is factual and balanced and is not misleading or fraudulent.

Consistent with the intention of the Commodity Futures Modernization Act

³⁶ See Transcript from CFTC Roundtable on Managed Funds Issues <<http://www.cftc.gov/files/opa/press02/oparountable091902.pdf>>.

³⁷ See the Investment Advisers Act of 1940 section 206(4) (15 U.S.C. 80b-6(4)) and Securities and Exchange Commission Rule 275.206(4)-1(a)(5) (17 CFR 275.206(4)-1(a)(5)). For a more complete discussion regarding the use of past performance by investment advisers for soliciting clients, see Robert J. Zutz, *Compliance Review*, Schwab Institutional, Vol. 10, Issue 8, Aug. 2001.

³⁸ See, e.g., Testimony of George Crapple at the CFTC Roundtable on Managed Funds Issues. Transcript from CFTC Roundtable on Managed Funds Issues at 84.

³³ See, Commission Rules 4.34(n) and 4.34(o).

³⁴ CFTC Advisory, "Adjustments for Additions and Withdrawals to Computation of Rate of Return in Performance Records of Commodity Pool Operators and Commodity Trading Advisors," 56 FR 8109 (February 27, 1991).

³⁵ CFTC Advisory, "Adjustments for Additions and Withdrawals to Computation of Rate of Return in Performance Records of Commodity Pool Operators and Commodity Trading Advisors," 56 FR 8109 (February 27, 1991).