

appropriate, permit the industry flexibility in the manner it complies with certain regulatory mandates. Moreover, a core principle regarding the presentation of past performance of partially funded accounts is consistent with the approach governing use of promotional material by CTAs and commodity pool operators ("CPOs").¹⁶ In addition, as noted in the proposing release, a core principle approach would also be consistent with Federal securities laws applicable to investment advisers, who generally may present past performance in any manner that does not run afoul of general anti-fraud provisions.¹⁷

The core principle requires that the disclosure must be presented in a manner that is balanced and is not in violation of the antifraud provisions of the Commodity Exchange Act (the "Act") or the Commission's regulations thereunder.¹⁸ Each of these two requirements must be complied with in order for the core principle to be met. First, the presentation must not violate the antifraud provisions of the Commodity Exchange Act. For example, a materially misleading disclosure would violate those provisions,¹⁹ and thus would violate this core principle. In addition, the presentation must be balanced. For example, a presentation that emphasizes past gains and minimizes past losses would fail to meet this requirement, and thus would violate the core principle.²⁰

¹⁶ Commission Rule 4.41 reiterates the anti-fraud provisions of Section 4o of the Act. NFA has promulgated its Compliance Rule 2-29 and issued interpretive notices, which provide more detailed guidance on the preparation and use of promotional material.

¹⁷ 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)). The SEC's general antifraud approach to performance disclosure, which is analogous to the core principle approach adopted herein, has not impeded the SEC's ability to bring enforcement actions for inappropriate disclosure. 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.

¹⁸ 7 U.S.C. 1 *et seq.* (2000); 17 CFR Ch. I (2002). Antifraud provisions under the Act and regulations include Sections 4b, 4o, and Regulations 1.1, 4.41, 30.9, 32.9 and 33.10.

¹⁹ See, e.g., *In re Slusser*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,701 at 48,311 (CFTC July 19, 1999), *aff'd in part and rev'd in part on other grounds sub nom. Slusser v. CFTC*, 210 F.3d 783, 784 (7th Cir. 2000).

²⁰ See also National Futures Association Compliance Rule 2-29(b)(3) (prohibiting the use of promotional material that "mentions the possibility of profit unless accompanied by an equally prominent statement of the risk of loss.") NFA has issued guidance interpreting this rule, see, e.g., NFA Interpretive Notices ¶ 9003.

Although a few commenters expressed concern that a core principle might impede the Commission's enforcement efforts, or limit them to "the most egregious cases," the Commission believes that the adoption of a core principle based on existing antifraud provisions, which also requires balance, in no way diminishes its current ability to address improper disclosure, nor its ability to address violations of that core principle consistent with its current authority to enforce the antifraud provision of the Act. The SEC has successfully brought actions under its anti-fraud authority against those who have used misleading performance presentations,²¹ and NFA has successfully disciplined members who have used unbalanced promotional material.²²

In addition to the amendment to Rule 4.35, the Commission is also adopting the definition of a "partially-funded account" and a conforming amendment to Rule 4.25 regarding the presentation of a CTA's partially-funded account performance in a commodity pool disclosure document.

The rule amendments being adopted herein relate solely to partially-funded accounts. In that regard, Advisory 93-13,²³ which the proposing release stated would be superseded by the adoption of the proposed rule amendments, will remain in effect until such time as the Commission and/or an appropriate self-regulatory organization adopts further guidance on the presentation of partially funded accounts. Other issues noted in the proposal published March 13, 2003, regarding performance presentation generally, such as changes in the calculation of drawdown figures and application of the Commission's 1991 Advisory concerning additions and withdrawals,²⁴ will be addressed in a subsequent **Federal Register** release.

III. Other Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.*, requires that agencies, in promulgating rules, consider the impact of those rules on

²¹ See, e.g., *In re F.X.C. Investors Corp. and Francis X. Curzio* 79 SEC 276 (2002) (Distribution of misleading performance information violates section 206(4) of Investment Advisers Act and SEC Rule 275.206(4)-1(a)(5)).

²² See, e.g., *Minogue Investment Company, Inc.* (NFA Case No. 98-App-006); *Vision Limited Partnership* (NFA Case No. 00-BCC-005).

²³ CFTC Advisory 93-13, 58 FR 8226 (February 12, 1993).

²⁴ 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 (Feb. 27, 1991).

small businesses. The Commission has previously established certain definitions of "small entities" to be used by the Commission in evaluating the impact of its rules on such entities in accordance with the Regulatory Flexibility Act.²⁵ The Commission previously has determined that registered CPOs are not small entities for the purpose of the Regulatory Flexibility Act.²⁶ With respect to CTAs, the Commission has stated that it would evaluate within the context of a particular rule proposal whether all or some affected CTAs would be considered to be small entities for purposes of the Regulatory Flexibility Act and, if so, to analyze the economic impact on them of any such rule at that time.²⁷ The Commission has previously determined that disclosure requirements governing CTAs do not have a significant economic impact on a substantial number of small entities.²⁸ Moreover, the amendments being adopted herein do not impose additional requirements on CTAs, but rather offer CTAs an alternative means by which to comply with existing Commission rules. Therefore, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that these regulations will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 ("PRA")²⁹ imposes certain requirements on federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the PRA. These rule amendments do not require a new collection of information on the part of any entities subject to the rule amendments. Accordingly, for purposes of the PRA, the Commission certifies that these rule amendments will not impose any new reporting or recordkeeping requirements.

C. Cost-Benefit Analysis

Section 15(a) of the Act requires the Commission to consider the costs and benefits of its action before issuing a new regulation under the Act. By its terms, Section 15(a) does not require the Commission to quantify the costs and benefits of a new regulation or to determine whether the benefits of the proposed regulation outweigh its costs. Rather, Section 15(a) simply requires

²⁵ 47 FR 18618-18621 (Apr. 30, 1982).

²⁶ 47 FR 18619-18620.

²⁷ 47 FR 18618-18620.

²⁸ See 60 FR 38146, 38181 (July 25, 1995) and 48 FR 35248 (Aug. 3, 1983).

²⁹ 44 U.S.C. 3501 *et seq.*