

stated in the Proposing Release, the purposes of these revisions are: (1) Simplification of past performance disclosures; (2) reduction of required disclosures concerning matters of secondary relevance; and (3) clarification and modernization of various requirements.<sup>4</sup>

In announcing the adoption of part 4 in 1979, the Commission stated that the Disclosure Document requirement for CPOs was intended "to protect pool participants—particularly those who are unsophisticated in financial matters—by ensuring that they are informed about the material facts regarding the pool before they commit their funds."<sup>5</sup> Similarly, the Disclosure Document requirement for CTAs was premised, in part, upon the view that "a prospective (CTA) client or subscriber should be aware of the advisor's commodity and general business experience if he is to make an informed decision as to whether or not to avail himself of the advisor's services."<sup>6</sup>

In the Proposing Release, the Commission noted that since the original adoption of the part 4 rules, the number of registered CPOs had more than doubled and the number of CTAs had increased nearly threefold;<sup>7</sup> assets under the management of CPOs had grown dramatically;<sup>8</sup> and the range of available futures and option contracts had increased substantially.<sup>9</sup> In addition, during the past decade, trading structures and investment portfolios have become increasingly diverse and complex. A single commodity pool may engage multiple CTAs and invest in multiple commodity pools ("investee pools")<sup>10</sup> or securities funds in order to access the services of particular traders or advisors, employ multiple trading strategies or programs, or diversify its portfolio.<sup>11</sup> Further, commodity pools frequently retain "trading managers" to recommend or select CTAs to manage, or funds in

which to invest, the pool's assets<sup>12</sup> and may employ dynamic asset allocation strategies entailing periodic replacement of, or reallocation of assets among, CTAs for the pool.

In implementing its statutory mandate to regulate the activities of CPOs and CTAs, the Commission has endeavored to refine its rules as appropriate to respond to changing market conditions in a manner consistent with customer protection.<sup>13</sup> The Commission's Division of Trading and Markets ("Division") has issued relief on a case-by-case basis to facilitate application of the disclosure requirements to new market conditions not contemplated by the existing regulatory framework, such as multi-advisor and fund-of-funds structures. The objective in such cases is to apply the rules so as to foster clear and succinct disclosure of material information, especially concerning fees and other aspects of fund operations affected by such structures, taking into account the particular characteristics of the offered investment vehicle.<sup>14</sup> In many cases, strict application of existing disclosure requirements to pools whose CPOs have voluminous performance histories or which invest through multiple CTAs or investee funds could result in undue emphasis upon performance record disclosure and reduced focus upon more germane data. These effects have been mitigated in

appropriate circumstances through grants of exemptive or no-action relief.<sup>15</sup>

Thus, the proposal to revise the part 4 rules reflected the Commission's experience in addressing a wide range of CPO and CTA disclosure issues under the prior rules, the evolution of the marketplace, the development of new trading structures and the views of the public and of market participants.

#### *B. National Futures Association Proposals*

As detailed in the Proposing Release,<sup>16</sup> on March 15, 1994, the National Futures Association ("NFA") submitted to the Commission proposed amendments to, and interpretations of, NFA's Compliance Rules based upon the recommendations of NFA's Special Committee for the Review of CPO/CTA Disclosure Issues ("NFA's Submission"). NFA's Submission consisted of several parts, including: Proposals concerning presentation of past performance data, including proposed capsule formats for CPO and CTA performance; proposed requirements for calculation and disclosure of break-even analyses by CPOs; proposed rules for the use of hypothetical trading results by NFA members in promotional material; and proposals dealing with the use of "nominal" or "notionally funded" accounts. The proposals requiring, and providing instructions for, break-even analyses were published for public comment and subsequently approved by the Commission on April 26, 1995, substantially as proposed.<sup>17</sup> Rule 4.10(j)

<sup>12</sup> 59 FR 25351, 25353. Rule 4.10(h) defines the term "trading manager," as discussed more fully below.

<sup>13</sup> See, e.g., Rules 4.5, 4.12(b) and 4.7, adopted in 1985, 1987 and 1992, respectively, and the discussion of those rules at 59 FR 25351, 25353.

<sup>14</sup> 59 FR 25351, 25353–25354. In reviewing Disclosure Documents for fund-of-funds structures, Division comment letters previously have stated that although pool documents should provide all information required by (former) Rule 4.21 for each investee pool, "generally at the same level of detail as though the investee pool were providing its own separate disclosure document," nevertheless reduced disclosures are appropriate where less than twenty-five percent of the assets of the offered pool would be invested in an investee pool. The Division has also provided guidance through interpretative statements and advisories with respect to past performance presentations in Disclosure Documents. See, e.g., CFTC Advisory 87–2, (1986–1987 Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶ 23, 624 (June 2, 1987), defining the term "beginning net asset value" for rate of return calculations; CFTC Advisory (unnumbered, dated February 27, 1991), (1990–1992 Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶ 25,005, permitting CPOs and CTAs to use alternative rate of return computation methods to more accurately reflect the return on funds available for trading during the period; and CFTC Advisory 93–13, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,554 (February 12, 1993), permitting the use of an alternative method for computing CTAs' rates of return.

As noted below (see n.15), the staff addresses specific requests for relief on a case-by-case basis.

<sup>15</sup> See, e.g., CFTC Interpretative Letter No. 94–12, (Current Transfer Binder), Comm. Fut. L. Rep. (CCH) ¶ 25,993 (December 27, 1993) (capsule performance disclosure permitted for CPO's other pools); CFTC Interpretative Letter No. 94–10, (Current Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶ 25,991 (December 16, 1993) (capsule performance disclosure permitted); CFTC Interpretative Letter No. 93–107, (Current Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶ 25,899 (October 26, 1993) (CPO permitted to omit disclosures concerning its single advisor pools in Disclosure Document for a multi-advisor pool under certain conditions); CFTC Interpretative Letter No. 92–12, (1990–1992 Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶ 25,343 (July 28, 1992) (CPO permitted to omit required disclosures concerning CTAs and investee pools allocated less than 10% of pool's assets under certain conditions); and CFTC Interpretative Letter No. 92–9, (1990–1992 Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶ 25,300 (June 1, 1992) (CPO permitted to use two-part Disclosure Document with past performance of CTAs in second part delivered contemporaneously with first part) and Advisory 27–92 (June 3, 1992) (Commission has no objection to use of two-part Disclosure Document subject to conditions set forth in Interpretative Letter 92–9), issued in connection therewith. The foregoing generally are discussed at 59 FR 25351, 25353–54.

<sup>16</sup> See 59 FR 25351, 25354.

<sup>17</sup> NFA Compliance Rule 2–13(b) and Interpretive Notice to Compliance Rule 2–13(b). The "break-

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Commission and the states, the appropriateness of a two-part format for pool Disclosure documents. See 59 FR 25351.

<sup>4</sup> 59 FR 25351. These revisions do not, however, affect the basic organizational structure of part 4. Thus, the subparts thereunder continue to apply as follows: subpart A, to definitions and exemptions (Rule 4.1 *et seq.*); subpart B, to the operations and activities of CPOs (Rule 4.20 *et seq.*); subpart C, to the operations and activities of CTAs (Rule 4.30 *et seq.*); and subpart D, to advertising (Rule 4.40 *et seq.*).

<sup>5</sup> 44 FR 1918, 1920 (January 8, 1979).

<sup>6</sup> 42 FR 9278, 9279 (February 15, 1977).

<sup>7</sup> 59 FR 25351, 25352 and n.7.

<sup>8</sup> 59 FR 25351, 25352 and n.8.

<sup>9</sup> 59 FR 25351, 25352 and n.9.

<sup>10</sup> Rule 4.10(d)(4) defines the term "investee pool," discussed more fully below.

<sup>11</sup> 59 FR 25351, 25353 and n.11.