

Rules 4.25 or 4.35, as applicable, and is presented following all required performance disclosures. Such additional performance information must not be misleading. For example, if additional performance information beyond the required five years is presented but the entire history of the pool or program is not covered, the additional performance results shown must be representative of the results that would have been shown if the entire history were presented. Thus, "cherry picking" of performance data to highlight positive performance is a misleading practice precluded under existing antifraud standards. Generally, inclusion of voluntarily provided performance data should be made on a result-neutral basis that results in inclusion of all similar data.¹¹⁹ The Commission also notes that the practice of advertising a pool by touting the excellent past performance record of a particular CTA to attract prospective participants and shortly thereafter reallocating pool assets to another CTA, a practice commonly referred to as "bait-and-switch," is misleading and that use of performance data in this manner would violate relevant antifraud provisions.

Any proprietary performance must be presented in accordance with Rule 4.25(a)(8) for CPOs and Rule 4.35(a)(7) for CTAs, as discussed below. Hypothetical, extracted, simulated and pro forma¹²⁰ performance information is also now required by Rules 4.4(v) and 4.34(n) to be presented separately after all other information.¹²¹

2. Proprietary Trading Results: Rules 4.25(a)(8) for CPOs and 4.35(a)(7) for CTAs¹²²

Proposed Rules 4.25(a)(9) and 4.34(a)(6) would have permitted CPOs and CTAs, respectively, to disclose proprietary trading results under

appropriate restrictions. Proposed Rule 4.25(a)(9) would have provided that the performance of pools and accounts in which the CPO, trading manager, CTA or other person providing services to the pool owns or controls fifty percent or more of the beneficial interest may not be included in pool Disclosure Documents unless prominently labeled as proprietary and set forth separately following all required performance and non-performance disclosures. Proposed Rule 4.34(a)(6) set forth similar restrictions for CTA Disclosure Documents with respect to accounts in which the CTA or any of its principals or any person providing services to the account owns or controls fifty percent or more of the beneficial interests.

While a number of commenters agreed with the intent of the Commission's proposal, *i.e.*, to prevent disguising of proprietary trading by including an insignificant amount of money from "outside" participants, other commenters claimed that the proposal would have the undesirable effect of discouraging CPOs from investing in their own pools. One commenter stressed that proprietary trading is often the only way a pool can begin trading before raising outside capital. Commenters suggested raising the threshold for ownership or control by the pool operator, advisor, principals or other service providers from fifty to between sixty and eighty percent. Commenters also asked the Commission to clarify that the interests in the pool of the CPO, the CTA, their principals and other service providers are not required to be added together when applying the fifty percent test in proposed Rule 4.25(a)(9) unless such persons are affiliated. One commenter urged that the definition of proprietary performance should be broadened to include both accounts for which the CPO, trading manager, CTA or respective principals receive no direct fees, as well as pools in which an affiliate or family member of the CPO, trading manager or CTA owns or controls fifty percent or more of the beneficial interest. Several commenters suggested that if proprietary accounts are traded in a manner similar to pool and customer accounts, the rules should permit CPOs and CTAs to include the performance in a composite with customer accounts, provided *pro forma* adjustments are made for fees and other differences.

The Commission is adopting Rule 4.25(a)(9) (renumbered as Rule 4.25(a)(8)) and Rule 4.34(a)(6) (renumbered as Rule 4.35(a)(7)) substantially as proposed, permitting presentation of proprietary performance

information, subject to restrictions intended to assure that the disclosure of such information is not misleading. Further, the Commission has determined to adopt the comment that accounts in which an affiliate or family member of the CPO, trading manager or CTA owns or controls fifty percent or more of the beneficial interest should be characterized as proprietary and has revised the rules accordingly. As adopted, the text of these rules has been reorganized for clarity and cross-references to the respective rule provisions governing placement of supplemental information have been included. The word "required" has been omitted to clarify the requirement that proprietary trading results (together with any hypothetical, extracted, pro forma¹²³ or simulated results) follow all of the other disclosures in a Disclosure Document.

Although proprietary performance results in CPO and CTA Disclosure Documents have a significant potential to mislead, given the often material differences in the conditions under which proprietary trading results as opposed to non-proprietary results are obtained, the Commission recognizes that proprietary trading results may be the only performance results available to some new traders to present to customers as evidence of trading experience.¹²⁴ The requirement that proprietary trading results be presented after all required and non-required disclosures, rather than just the required performance disclosures, reflects the relatively low utility of such data to prospective customers and the relatively high potential for confusion of proprietary and customer trading results. Given the significant potential

¹²³ See discussion in Section 3, *infra*, concerning required pro forma adjustments.

¹²⁴ As the Commission explained in its proposal,

Use of proprietary trading results in soliciting customer accounts is a practice which has long been of concern to the Commission. CPOs and CTAs may trade proprietary funds for a variety of purposes, including to test a new trading strategy before implementing it for customer funds or to establish a track record prior to trading customer funds. However, proprietary accounts may be traded in a different manner, for example, more aggressively, using higher leverage and assuming greater risk, than customer accounts. Also, proprietary accounts are usually not subject to the same fee schedule as customer accounts. Naturally, no management or incentive fee would apply where a CTA traded its own account, and clearing fees may be waived or reduced if the account is cleared by an affiliate. In addition, where proprietary and customer assets are combined for purposes of performance presentations, the total amount of assets under management is inflated and conceals the actual amount of customer funds being traded. For these reasons, proprietary trading results may, in many cases, be of little relevance to a prospective pool participant or CTA client and actually misleading in others. 59 FR 25351, 25360.

¹¹⁹ Thus, for example, and as the Commission explained in the Proposing Release, in the case of a pool meeting the criteria of Rule 4.25(b), where only the past performance of the offered pool is required, the past performance of two CTAs each allocated an equal portion of the pool's assets generally should either be included for both CTAs or omitted entirely. Similarly, where only the past performance of the offered pool is required, generally the past performance of the CPO's other pools should be shown in total or omitted. *Id.*

¹²⁰ As discussed in section 3, *infra*, pro forma adjustments to performance data are required for certain purposes and such adjustments are not affected by the restrictions upon placement of supplemental information.

¹²¹ If a Disclosure Document contains two or more of these types of performance information, the registrant may choose the order of presentation between or among them at the end of the document.

¹²² The Commission's former disclosure rules did not specifically address the placement of proprietary trading results.