



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and  
Intermediary Oversight

Thomas J. Smith  
Chief Accountant

CFTC letter No. 06-04  
August 29, 2005  
Exemption  
Division of Clearing and Intermediary Oversight

Re: Regulation 4.35 – Request for Exemptive Relief Regarding Commodity Trading  
Advisor Past Performance Disclosure Requirements

Dear :

This is in response to your letter dated March 28, 2005, to the Division of Clearing and Intermediary Oversight ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by telephone conversations with Division staff. By your correspondence, you requested, on behalf of "X", relief from the requirements of Rule 4.35 regarding composite presentation of the past performance of trading principals of a commodity trading advisor ("CTA").

X is a registered CTA under the Commodity Exchange Act ("Act").<sup>1</sup> X offers a trading program to its clients and maintains a performance record for its trading on behalf of its clients. In addition, one of X's principals, "Y", has discretionary authority over approximately 40 customer accounts in his capacity as an AP of a futures commission merchant ("FCM") that is not affiliated with X ("Y Accounts"). While there are similarities with respect to the types of futures markets traded between the X trading program and the trading conducted in the Y Accounts, the actual trading conducted in the Y Accounts and positions established are different from X's program. In addition, the trading results among the Y Accounts often differ significantly from each other due to factors such as sizes of the accounts and customization of the trading strategies – for example, customers may participate in different markets, have different risk tolerances, or customers may enter some trades for the accounts themselves.

Commission Rule 4.35(b) requires that a CTA include in its disclosure document the past performance of accounts directed by the CTA and its trading principals for the prior five years and the current year to date. Rule 4.35(a)(3) states that accounts that differ materially with respect to rates of return may not be presented on a composite basis. The disclosure document that X filed with the National Futures Association ("NFA") included past performance information for X's trading program and included a single composite capsule presenting the performance of the Y Accounts. NFA, however, noted in a 2004 examination of X certain material differences among the rates of return for the Y Accounts and, pursuant to Rule 4.35(a)(3), the Y Accounts could not be presented in a single composite capsule. Absent relief

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<sup>1</sup> 7 U.S.C. §6m(1) (2000).

thereunder, X would be required to disclose the performance of the Y Accounts in separate performance capsules.

X has requested relief from the requirement of Rule 4.35(a)(3) to present separate or non-composite performance for the Y Accounts. Presenting the performance in additional separate performance capsules, perhaps as many as one capsule per account, would result in numerous performance capsules, overwhelming prospective clients with excessive amounts of data on accounts and a trading program that bears little, if any, relationship to X's trading program. In order to provide more meaningful disclosure to prospective X clients, the Division believes that an expansion of the capsule format of Rule 4.35(a)(1) that includes the range of data for each capsule element would allow the performance of the Y Accounts to be presented in a single capsule while providing adequate information about the varying results experienced by the accounts.

Based upon the foregoing, the Division believes that granting conditioned relief would not be contrary to the public interest or the purposes of Rule 4.35. Accordingly, by the authority delegated under Rule 140.93(a)(1), the Division exempts X from the specific requirements of Rule 4.35(a)(1) and (3) to disclose performance information separately for each of the Y Accounts, on the condition that X's disclosure document presents the performance of the Y Accounts in a format, which may be a narrative, that includes the following information:

- An explanation of the fact that Y trades the accounts as an employee of an FCM;
- The number of Y Accounts;
- The aggregate assets in the Y Accounts;
- The range of sizes of the Y Accounts;
- The date when Y began trading the Y Accounts;
- A description of the customized nature of the trading done for the Y Accounts, and any other factors that result in differences among the accounts, as well as an explanation of the similarities and differences between the trading for these accounts and the X trading program(s);
- The worst monthly percentage drawdown of any of the Y Accounts, for the most recent five calendar years and current year to date, and the month and year of such drawdown;
- The worst peak-to-valley percentage drawdown of any of the Y Accounts, for the most recent five calendar years and current year to date, and the months and year(s) of such drawdown;
- The range of returns for the Y Accounts, which may be presented either based on the lifetime returns of all the accounts, or on an annual basis; and
- The number of accounts closed with profits, and the number of accounts closed with losses, for the most recent five calendar years and current year to date, for the Y Accounts.

This letter, and the relief granted herein, is based upon the representations that have been made to the Division and are subject to compliance with the conditions set forth above. Any different, changed, or omitted facts or conditions might render the exemption void. You must notify the Division immediately in the event that the operations or activities of X change in any material way from those represented to us.

This letter exempts X solely from the requirements of Rule 4.35(a)(3) with respect to the performance of the Y Accounts. It does not excuse X from compliance with any other aspect of the Commission's disclosure requirements, nor does it excuse X from compliance with any other applicable requirements contained in the Act or the Commission's regulations issued thereunder.

If you have any questions concerning this correspondence, please contact Eileen R. Chotiner at (202) 418-5467.

Very truly yours,

Thomas J. Smith  
Chief Accountant

cc: Regina Thoele  
Vice-President, Compliance  
National Futures Association