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# MANAGED FUNDS ASSOCIATION

Via Electronic Mail: secretary@cftc.gov

COMMENT

April 14, 2003

Ms. Jean A. Webb
Secretary of the Commission
Commodity Futures Trading Commission (CFTC)
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Performance Data and Disclosure for Commodity Trading Advisors (68 FR 12001, March 13, 2003)

Dear Ms. Webb:

Managed Funds Association (MFA) is pleased to provide comment on the proposed rule amendments that Commission has developed concerning the above-referenced proposed CFTC regulations on Performance Data and Disclosure for Commodity Trading Advisors, and the accompanying release cited above (individually or collectively, the "Proposed Rules"). This letter, urging the CFTC to adopt these proposed amendments with the suggested revisions herein, is written on behalf of Managed Funds Association. MFA is the only US-based membership organization dedicated to serving the needs of professionals the hedge fund and futures fund industries, including commodity pool operators (CPOs) and commodity trading advisors (CTAs). Our over 600 members manage a significant portion of the estimated $600 billion invested in these alternative investment vehicles. Capitalized terms used herein, unless otherwise defined, shall have the same meaning as set forth in the Proposed Rules.

MFA applauds the Commission for publishing the Proposed Rules after many years of examining and revising the substance thereof. MFA, and its members, have contributed a great deal of effort in working with the Commission on these Proposed Rules. MFA continues to believe that disclosure of actual funds under management is not a meaningful disclosure. Since CTAs are prohibited from holding customer funds, actual funds managed by a CTA are not a measure of client trust in the CTA's trading methods. It is also not a measure of trading activity or risk undertaken for an account, and so it is potentially misleading to investors.

The Proposed Rules, as currently drafted, alleviate many of the prior issues and concerns that our organization has raised with the Commission in the past. While we urge the Commission to adopt final Rules because of the utility that they will offer CTAs, we feel the Commission must consider some final suggested comments set forth below. With certain revisions, MFA believes that the Proposed Rules would achieve their full regulatory purpose which is to provide CTAs with important flexibility in stating past performance for prospective clients incorporating nominal accounts while balancing a client's need to obtain an accurate picture of that performance.

**Performance Calculations**

Turning to specific points raised by the Proposed Rules, the first issue we would like to address relates to amendments to CFTC Rule 4.35(a)(6)(i)(G) concerning a CTA's rate of return computation. The Proposed Rules state that the "Only Accounts Traded Method" would not be an option that "CTAs may choose prospectively due to concerns that it allows for accounts to be excluded entirely from the rate of return computation." (68 FR 12007). The Commission then states that it will "carefully consider proposals regarding any alternative method of addressing the effect of additions and withdrawals on the rate of return computation." (*Id.*) MFA disagrees with this approach and urges the Commission to adopt some of the exclusions allowed in Advisory 93-13, particularly to eliminate from both the numerator and denominator those accounts opening or closing intra-month. This type of account activity, if included, can materially distort the rate of return for a given month. Moreover, this distortion would require the CTA to adopt the daily rate of return computation. Accordingly, MFA would like to work with the Commission in revising this portion of the Proposed Rule.

**Range of Rates of Return for Closed Accounts**

Second, the Commission is proposing to revise Rule 4.35(a)(1)(viii) to require that the performance capsule for the offered CTA program include, in addition to the number of accounts closed with profits and those closed with losses, the range of rates of return for the accounts closed with net lifetime profits and those closed with net lifetime losses during the five-year period (as now defined). We disagree that this would provide important summary information on the variation in returns experienced by individual clients or in the utility of this information for prospective clients. Rather, MFA believes that this information would be a form of "information overload" with no meaningful benefit to the prospective CTA client.

**Advisor Agreements**

Third, MFA has concerns about Proposed Rule 4.33(c) that would require new documentation of the agreement between a CTA and client. New paragraph (c) to Rule 4.33 would require documentation of the nominal account size agreed upon, and other terms set forth in the Proposed Rule, between the CTA and client. Furthermore, this new amendment would apply even where all of a CTA's client accounts are fully-funded. In

effect, a CTA would have to go back to each of its clients with fully-funded accounts and obtain a statement that would incorporate the new Rule 4.33(c) requirements. MFA finds this requirement burdensome and problematic for these types of CTAs because we do not feel that these types of fully-funded account arrangements require additional documentation; nor do we believe that it would achieve any meaningful regulatory objective by the Commission.

**Additional Disclosures Concerning Draw Down**

MFA would also like to raise two issues related the presentation of draw-down figures for CTAs that accept partially-funded accounts. The first point relates to institutional clients. The Proposed Rules are written from the point of view that partially funded accounts, or "notional funding", is something that CTAs sell to clients. To the extent that is true, the safeguards included in the Proposed Rules are appropriate. In many cases, however, notional funding is sought by institutional clients, and for those situations, MFA would propose that the additional disclosure requirements, as reflected in Proposed Rules 4.35 (a)(1)(v) and (vi), and 4.35(a)(1)(ix) (A), for example, need not be made to qualified eligible purchasers (QEPs), as defined in CFTC Rule 4.7. This would parallel the treatment in National Futures Association (NFA) compliance rule 2.29(c)(6) regarding the use of hypothetical performance presentations—the more protective rule would not apply to presentations to QEPs who can evaluate the claims made using notional funding, as well hypothetical data.

MFA's second point on the draw-down disclosures addresses the source of the 20% attribution rate for lowest funding levels in Proposed Rule 4.35(a)(1)(ix)(A). The final rules, or adopting release, should provide an explanation giving the source of the 20% attribution rate for lowest funding levels in proposed Rule 4.35(a)(1)(ix)(A). This Proposed Rule does not appear to reflect any basis for selecting the 20% figure. By explaining the source of this attribution rate, the description could be incorporated into the disclosure materials prepared by a CTA. Otherwise, the use of this 20% figure is likely to confuse a CTA's clients.

**Disclosure of Partially Funded Accounts**

MFA next point concerns the requirements of Proposed Rule 4.34(p) of, among other information, the computation of management fees. Under this Proposed Rule, CTA would have to provide in the disclosure document provided to prospective clients, a discussion of the impact the use of partially-funded accounts has on: (1) a CTA's management fees, (2) the estimated range of the CTA's commissions, and (3) leverage and the impact on rates of return, involving many details related to these issues. Under this Proposed Rule, the CTA would also have to provide a description of the factors used to determine the level of trading for a given nominal account size and how those factors are applied. MFA does not believe the additional information related to commissions or management fees, as would be required under the Proposed Rule, is relevant for clients in determining whether to engage a particular CTA. Information on leverage and factors

used in determining the level of trading for nominal accounts would generally be reflected in the CTA agreement.

**The Core Principle Alternative**

As our final point, MFA would like to highlight its concerns regarding the proposed adoption of a "core principle" for CTAs to use in presenting past performance to prospective clients. MFA's view is that the merits of historical performance continuity and comparability (mentioned as a particular goal of the Commission in the Proposed Rules) outweigh the flexibility of core principles. The details of this release indicate the many variables that could come into play if core principles were the only guidance on performance presentations. Core principals allow flexibility that is important in dynamic situations such as the environment for commodity trading. However, discipline in reporting is essential to achieve a common understanding of the performance reports issued. Therefore, MFA suggests that the Commission adopt *formal* rules, but ones that are not so specific or prescriptive that they are unworkable in changing circumstances. The final rules should establish a compliance safe-harbor whereby limited departure is permitted with the burden on the CTA to establish, through clear and convincing evidence, that such departure was consistent with the core principles and not misleading.

**Conclusion**

Once these concerns are addressed, MFA believes that the Proposed Rules should be published by the CFTC as final rules. I would be happy to discuss these comments with you in greater detail, please call me at (202) 367-1140 at your convenience.

Thank you for your attention to this matter.

Sincerely,

John G. Gaine
President