U.S. Department of Commerce, 14th Street and Constitution Avenue, NW., room H4886, Washington, DC 20230. Records in this facility, including written public comments and memoranda summarizing the substance of oral communications, may be inspected and copied in accordance with regulations published in part 4 of title 15 of the Code of Federal Regulations. Information about the inspection and copying of records at the facility may be obtained from Ms. Margaret Cornejo, the Bureau of Export Administration Freedom of Information Officer, at the above address, or by calling 202/377-2593.

List of Subjects in 15 CFR Part 700

Administrative practice and procedure, Business and industry, Government contracts, National defense, Reporting and recordkeeping requirements, Strategic and critical materials.

Accordingly, part 700 of the National Security Industrial Base Regulations (15 CFR part 700) is amended as follows:

PART 700 [AMENDED]

1. The authority citation for part 700 is revised to read as follows:

Authority: Secs. 101-103, 701-707, 709, and 713, Defense Production Act of 1950 (Pub. L. 81-774, 64 Stat. 798,) as amended (50 U.S.C. app. 2071-2073, 2151-2157, 2159, and 2163); E.O. 10480, 3 CFR 1949-53 Comp. p. 962, as amended; E.O. 12148, 3 CFR 1979 Comp. p. 412, as amended; Defense Mobilization Order (DMO) 3, 44 CFR part 322; DMO-12, 44 CFR part 329; DMO-13, 44 CFR part 330, 50 U.S.C. 486, 10 U.S.C. 4501 and 9501, 50 U.S.C. 82, and Executive Order 12742 of January 8, 1991, 56 FR 1079.

2. Schedule I to part 700 is amended by adding a new entry to read as follows:

Schedule I to Part 700—Authorized Programs and Delegate Agencies

Program identification symbol	Authorized program	Delegate agency
* * *	*	*
C1	Food resources	Department of Defense
* * *	*	*

Dated: February 19, 1991.

John A. Richards,

Deputy Assistant Secretary for Industrial Resource Administration.

[FR Doc. 91-4274 Filed 2-26-91; 8:45 am]

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COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 4

Adjustment for Additions and Withdrawals to Computation of Rate of Return in Performance Records of Commodity Pool Operators and Commodity Trading Advisors

AGENCY: Commodity Futures Trading Commission.

ACTION: Advisory.

SUMMARY: A performance record contains information required to be presented by commodity pool operators ("CPOs" or "registrants") and commodity trading advisors ("CTAs" or "registrants") pursuant to Commodity Futures Trading Commission ("Commission") rules 4.21(a)(4), 4.21(a)(5) and 4.31(a)(3) [1] and is intended to present the historical periodic performance of accounts operated or directed by such registrants in a prescribed format for purposes of disclosure to customers or prospective customers. The prescribed format includes periodic rate of return ("ROR") information. By this Advisory the Commission is providing guidance as to the acceptable methods of computation of ROR. This Advisory also provides guidance as to the use of Value Added Monthly Index ("VAMI") columns in performance table presentations.

The Commission is aware that many registrants have already adopted the alternative methods of computation discussed herein, which Commission staff have reviewed and determined to be acceptable in specific cases. As a result, the Commission believes that the accuracy of ROR information appearing in performance disclosure generally has been improved. This Advisory is intended to provide guidance concerning those circumstances in which the ROR computed in accordance with the method currently specified in Commission rules could be misleading and to make generally available alternative methods of ROR computation that have been previously reviewed and accepted for many registrants on a case-by-case basis. The guidance provided by this Advisory also should assist registrants in more efficiently preparing their performance tables, reduce the necessity for inquiries concerning specific ROR computations, and afford registrants more latitude in the presentation of ROR.

DATES: The Advisory is to be effective March 29, 1991.

[1] Commission rules referred to herein are found at 17 CFR Ch. I (1990).

ADDRESSES: Comments should be sent to Commodity Futures Trading Commission, 2033 K Street NW., Washington, DC 20581. Attn: Secretariat.

FOR FURTHER INFORMATION CONTACT: Paul Bjarnason, Chief Accountant, Division of Trading and Markets, Commodity Futures Trading Commission, 2033 K Street NW., Washington, DC 20581. Telephone: (202) 254-8955.

SUPPLEMENTARY INFORMATION:

I. Introduction

The account information required by Commission rules to be provided in CPO and CTA performance records includes: Beginning net asset value ("BNAV"); [2] additions of funds; withdrawals of funds; net performance; ending net asset value; ROR; and, for pools, the number of units outstanding at the end of the period.[3] ROR is currently defined in Commission rules as net performance for a period divided by the BNAV for that period.[4] It has come to the Commission's attention that distortions in computed ROR under the method currently specified can result under some circumstances. For example, distortions can result where additions and/or withdrawals are large and are made early in the reporting period, because such additions/withdrawals cause the actual amount of funds available for trading during a period to be materially different from BNAV.

Accordingly, to assure that performance records reflect accurate RORs notwithstanding unusual circumstances, this Advisory provides guidance as to the circumstances in which ROR computations under the method currently specified in Commission rules can result in distortions, and thus an alternate method of computation is required, and as to acceptable alternate methods for such computations. In addition, concurrently with the publication of this Advisory, the Commission is publishing

[2] With respect to the calculation of BNAV, Commission staff has stated that funds contained in a commodity account over which the CTA has been given discretionary trading authority must be included in the BNAV calculation and specifies conditions under which funds in other types of accounts of the customer at the futures commission merchant that are committed to the registrant's trading program are required to be included in the computation of BNAV. Division of Trading and Markets Advisory No. 87-2, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,624 (June 2, 1987).

[3] In some cases, pools are not denominated in units and, therefore, the number of units outstanding at the end of the period would not be required. This fact should be indicated in a note to the performance record.

[4] Rule 4.21(a)(4)(ii)(F), 17 CFR 4.21(a)(4)(ii)(F).

proposed rule amendments which, among other things, will clarify that presentation of ROR may be made by the method currently specified in Rule 4.21 as well as by such other methods as the Commission may approve.[5] The proposed revision to Rule 4.21(a)(4) would provide that the rate of return for the performance period being shown "shall be calculated by dividing the net performance by the beginning net asset value *or by a method otherwise approved by the Commission*" (emphasis added).[6] The Commission also has proposed to amend Rule 140.93(a) to add new paragraph (a)(7), a delegation of authority to the Director of the Division of Trading and Markets to perform "[a]ll functions reserved to the Commission in [Rules] 4.21 and 4.31."

This Advisory specifies five methods of computation of ROR. Each of the methods is acceptable to the Commission provided resultant RORs are not misleading. This Advisory provides guidance as to what circumstances might lead to inaccurate RORs and emphasizes that in circumstances in which material distortions occur, an accurate alternative calculation must be made. For example, in those cases where additions and withdrawals occur only at the end of the reporting period, or are so distributed as to result in no distortion, the previously specified method of calculating ROR, net performance for a period divided by BNAV for that period, would be acceptable. When additions or withdrawals could distort performance results, the methods for computing ROR as provided herein, including "time-weighting", average daily equity ("ADE") and only accounts traded ("OAT"), will be accepted by the Commission for purposes of compliance with ROR requirements under Rules 4.21(a)(4), 4.21(a)(5), and 4.31(a)(5). The Commission will also accept a compounded ROR method, provided compounding is done at least as frequently as additions and withdrawals occur, because such a method accurately matches trading performance for a period against the actual equity which was available for trading during that period. These types of computations were suggested in comments responding to a Commission interpretive statement and request for comments issued in 1989, which raised the issue of distortions to performance reporting caused by additions or withdrawals.[7]

II. Proposed Adjustments to Computation of Rate of Return

A. General Requirements

Whichever method of computing ROR is selected, registrants are required to indicate the method in notes to the performance records and are required to maintain complete and clear records to support the computation. Accounting data which underlie the computation must be prepared in accordance with generally accepted accounting principles ("GAAP") as required by Commission regulations. All additions and withdrawals should be set forth in separate columns. GAAP and other Commission rules require accounting on an accrual basis for all items of income and expense; preclude pro forma adjustments unless specifically disclosed; require inclusion of all accounts, including short-term loss accounts, except as provided in the OAT method discussed herein; and require inclusion of all fees and expenses pertaining to the account and its trading, even those paid with funds from outside of the trading account.

The registrant is responsible for the accuracy of any method chosen to address the impact of additions and withdrawals upon ROR; is required to apply the chosen method consistently from period to period; and may not depart from the chosen method, unless performance would otherwise not be properly represented. In such cases, corrective adjustments may be made and explanation must be included in the notes.

B. Standard of Materiality

As previously stated, registrants may use the prior Commission method for calculating ROR unless it results in material distortion of performance results. However, all the methods described herein are potentially subject to distortion and where such distortion would occur the registrant must choose one of the alternative methods for that reporting period. For purposes of this Advisory the following summarizes the materiality threshold below which a registrant would not need to consider whether additions or withdrawals could distort the performance record:[8]

(1) The change in ROR, between the adjusted and the unadjusted ROR, is less than 10 percent of adjusted ROR;

(2) Additions and withdrawals are each less than 10 percent of BNAV;

(3) Unadjusted ROR is greater than 5 but no greater than 10 percent and the absolute difference between the unadjusted and the adjusted ROR is less than 1.5[9] percentage points; or

(4) Unadjusted ROR is 5 percent or less and the absolute difference between the unadjusted and the adjusted ROR is less than 1 percentage point.

C. Alternative Computations Under Rule 4.21(a)(4)(F)

In addition to the currently specified method of calculating rate of return by dividing net performance by the beginning net asset value, the following four alternative methods are acceptable for computing ROR: (1) The average daily equity ("ADE") method; (2) the time-weighting method; (3) the only accounts traded ("OAT") method; and compounded ROR method, which are described below.

Average Daily Equity ("ADE")

The ADE method for computing ROR involves the division of periodic net performance by ADE, which is an arithmetic average of the daily net liquidating equity available for trading for each day of the reporting period, *i.e.*, the total of the net liquidating equities for each day of the period divided by the number of days in the period. For Saturdays, Sundays, and other days when no commodity trading occurs, the preceding business day's net liquidating equity should be used. ADE as indicated on the account statement must be adjusted daily to accrue for material expenses and fees not already charged against the account in computing daily net liquidating equity, if any.

Although the ADE method is generally very accurate, it is subject to distortion during periods when because of severe losses, account equity is being drawn down rapidly.

[5] CPOs and CTAs are required to disclose all material information to existing or prospective pool participants or existing or prospective clients, respectively, even if such information is not otherwise specifically required by the Commission's disclosure rules. See 54 FR 5597, 5599 (1989). Commission Rules 4.21(h) and 4.31(g) and section 4o of the Commodity Exchange Act, 7 U.S.C. 6o (1988).

[6] Rules 4.21(a)(5) and 4.31(a)(3) incorporate by reference the rate of return calculation of Rule 4.21(a)(4).

[7] See "Statement of the Commodity Futures Trading Commission Regarding Disclosure by Commodity Pool Operators of Past Performance Records and Pool Expenses and Request for Comments", 54 FR 5597 (February 6, 1989).

[8] These standards apply equally to positive and negative RORs.

[9] For example, if the unadjusted (originally computed) ROR were 6 percent and the adjusted ROR were 8 percent, the absolute difference would be 2 percentage points and the relative difference would be 33⅓ percent. If the unadjusted ROR exceeds 10 percent, then only the first threshold set forth above would apply.

Time-Weighting of Additions and Withdrawals ("time-weighting")

Under the time-weighting method BNAV is adjusted by the time-weighted value of additions and withdrawals, *i.e.*, adjusting BNAV upwards by time-weighted additions and downwards by time-weighted withdrawals, occurring during the period. The time-weighting method is easily computed by taking the number of days funds were available for trading divided by the total number of days in the period. For example, if actual BNAV were $100,000 and an additional $150,000 was deposited on the 10th of the month, and $90,000 was withdrawn on the 20th of the month, the $100,000 BNAV would have to be adjusted: (1) Upward by two-thirds of the $150,000, or $100,000, because these funds were available for 20 days of the month; and (2) downward by one-third of the $90,000, or $30,000, because these funds were not available for one-third of the month. Therefore, the adjusted BNAV which should be used in computing ROR would be $170,000 or a 70 percent increase over actual BNAV.[10]

Although the time-weighting method is generally very accurate, it is subject to distortion during periods of very large changes in account equity due to severe losses or large profits.

Only Accounts Traded ("OAT")

The OAT method for computing ROR uses the formula contained in Commission regulations, *i.e.*, dividing periodic net performance by BNAV, except that it differs from the Commission's method in that certain accounts could be excluded from the computation. The exclusions are permitted in order to reduce the complexity and burden of the computation and are predicated on the assumption that the accounts excluded would distort ROR if they had been included. The conditions set forth below for the use of OAT are intended to assure that the exclusion of certain of the accounts will not result in the computation of periodic ROR that is materially different from the other methods.

The conditions which must be met for use of the OAT method are:

(1) Accounts included in any performance table using the OAT method must be similar in all material respects, *i.e.* type and relative number of contracts traded, margin/equity ratio, and fees and commissions charged.[11] To avoid distortion of ROR, accounts excluded from the computation must, as a group, have the same profile in this connection as those included in the computation, for the period used in the calculation.

(2) Accounts excluded from the ROR computation must not be charged with material non-recurring costs, *e.g.*, closeout costs charged against customer accounts in the period that they are closed. As with all the method, OAT may not be used if it would result in a systematic exclusion of any costs which would be material in amount.

(3) Each account excluded from the computation must meet at least one of the following criteria:[12]

(a) The account was open for only part of the period, *i.e.*, it was opened or permanently closed during that reporting period;

(b) The account had no open positions for any part of the period and it was the client's intention to close the account as evidenced by the actual permanent closure of the account shortly after the period-end. Accounts for which there was merely a trading pause may not be excluded from the computation solely because of such pause; or

(c) The account had material additions or withdrawals, *i.e.*, additions or withdrawals which exceeded 10 percent of BNAV attributable to the particular account.

(4) The registrant must disclose whenever unusual circumstances unique to the OAT method have affected ROR for any period, making resultant ROR diverge materially from what might be expected using one of the other acceptable methods.[13]

Registrants should be particularly concerned as to possible ROR distortion should a significant number of the accounts otherwise included in the table be excluded from the ROR computation.

Compounded ROR Method

The "compounded ROR method" is computed by dividing the accounting period, *i.e.*, the month or quarter, into several smaller periods and computing the ROR for such sub-period. Compounding may be done on as frequent a basis as daily, but, at a minimum, compounding must be done at least as frequently as additions and withdrawals are made. An example of the compounded ROR method in which an ROR for a sub-period has been computed each time there is an addition or withdrawal of capital to/from the account is provided below. Once an ROR has been computed for each sub-period, such RORs are combined into an overall ROR by multiplying them by one another in sequence, *i.e.*, compounding them.

An example of an ROR computation is as follows:

	account value	Change in value
Start of month	$10,000	+10% ($1,000 profit)
End of 1st acct. period.	11,000	$4,000 (addition)
Start of 2nd acct. period.	15,000	−20% ($3,000 loss)
End of 2nd acct. period.	12,000	$2,000 (withdrawal)
Start of 3rd acct. period.	10,000	+25% ($2,500 profit)
End of month	12,500	

$ROR = [(1+.1)(1-.2)(1+.25)] = 10\%$ gain for the period.

III. Value Added Monthly Index ("VAMI")

Although not required by Commission regulations, the performance tables of many registrants present in an additional column an index referred to as "VAMI". VAMI is an index purporting to reflect how a fixed amount of initial investment, generally $1,000, would have changed over the periods presented in the table. The Division of Trading and Markets has found cases where disclosure documents, as filed initially, have not accomplished this objective and the resulting VAMI could be misleading. In order to accurately accomplish its objective, the VAMI must change proportionately with the changes in the value of the underlying portfolio. For example, if on the fifteenth of January $100,000 were deposited in a new account and during January due to profits the account equity grew to $110,000, the ROR computed by time-

[10] Detailed computation: April 01–10=10 days×100,000=1,000,000; April 11–20=10 days×250,000=2,500,000; April 21–30=10 days×160,000=1,600,000; Total of above 5,100,000. 5,100,000 divided by 30 days=170,000 average.

[11] This requirement is generally applicable in determining when separate composite performance records must be prepared for accounts which are materially different, regardless of the method used to calculate ROR. See, *e.g.*, Rules 4.21(a)(4), 4.21(a)(5), and 4.31(a)(3).

[12] It shoudl be noted that it is only the computation of ROR which may exclude certain accounts under the OAT method. The other columns of the performance table, *e.g.*, BNAV, additions, withdrawals, net performance, etc., would be comprised of all accounts, including those excluded under the OAT method in the computation of ROR.

[13] For example, if a particular account or accounts are left out of an ROR computation for more than one period in a performance table, the registrant should consider presenting such accounts in a separate composite performance table or otherwise provide specific disclosure of the performance results of such accounts.

weighting would be 20% [14], but the VAMI, provided it were correctly stated, would increase 10 percent [15] from the initial $1,000 to $1,100, thereby tracking the change in the underlying portfolio.[16] Therefore, in order to compute a VAMI which tracks the underlying portfolio, in some cases the month's ROR may not be used and, in such cases, a separate computation must be made.

Distortions in VAMI may be aggravated by compounding. For example, if there were an overstatement of $100 in the VAMI of December 1989 and the compounded annual ROR for 1990 were 80 percent, such $100 distortion from 1989 would increase to $180 by December 1990.

VAMI is the most meaningful when presented on an annual basis. The Commission believes that most readers of performance tables review past performance in incremental periods, *e.g.*, the past year, the year before last, *etc.* For this reason the most meaningful VAMI would be one which facilitates such annual performance review, *i.e.*, where the VAMI is reset to the initial amount annually. Therefore, for this reason and for the additional advantage of the mitigation of distortions, the Commission strongly encourages the annual resetting of VAMI to the initial amount.

In view of the foregoing, the Commission's policies respecting the presentation and restatement of prior period VAMIs are as follows:

(1) Periodic ROR may be used to compute VAMI, provided no material distortion results. However, if the resulting VAMI would be misleading, an alternative computation to achieve an accurate VAMI, which is parallel to the actual change in the portfolio due to profits and losses, must be made.

(2) Where there are material distortions in the VAMI of the most recent three years presented, such VAMI must be recomputed and restated for each year.

(3) Where VAMI for periods earlier than the most recent three years presented contains material distortions, such distortions need not be corrected, provided the VAMI is reset to the initial amount annually for all periods presented.

(4) VAMI is a disclosure not required by Commission regulations and, therefore, need not be included in a performance record.

IV. Application of the Advisory to Historical Performance Records

Where prior period RORs otherwise would be materially distorted, registrants should amend the performance tables and/or the footnotes to the extent necessary to ensure that the historical performance record used in a current disclosure document is not misleading.[17] In order to reduce the burdens of full retroactive application of this Advisory registrants should consider the adequacy of: Limiting restatements of prior periods to those periods where distortions are likely to be the most serious; making changes to the VAMI presentation, such as resetting to the initial amount annually, as discussed above; providing additional explanatory disclosures in the notes; and whether any possible distortions may be in reporting periods which are of lesser concern, *e.g.* prior to the past three years of performance which is required by Commission rules. Registrants who are concerned that their performance tables as originally presented may be considered misleading may request the views and guidance of the Division of Trading and Markets staff on a case-by-case basis.

Issued in Washington, DC on February 21, 1991, by the Commission.

Lynn K. Gilbert,

Deputy Secretary of the Commission.

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[14] Time-weighting computation of ROR: 15 days divided by 30 days=50 percent: 50 percent times $100,000=$50,000; $10,000 divided by $50,000=20 percent ROR for the month.

[15] Computed by dividing the $10,000 by $100,000.

[16] Example of Incorrect VAMI Computation:

	ROR	VAMI	Computation
Jan	20%	1,100	(1,000 times 1.20=1,220).
Feb	20%	1,440	(1,200 times 1.20=1,440).
March	15%	1,656	(1,440 times 1.15=1,656).