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October 28, 1999

Jean A. Webb
Secretary of the Commission
1155 21st Street NW
Washington DC 20581

Via e-mail: "secretary@cftc.gov"

RE: 17 CFR Part 4 Performance Data and Disclosure for Commodity Trading Advisors - 64 FR 41843 (August 2, 1999)

Summary: For the required disclosure of the worst monthly drawdown in a CTA program, the Commission has proposed to change its rules, so as to use for this disclosure the worst monthly rate-of-return from the CTAs performance table for a *composite* of all accounts in a program, in lieu of the worst-performing *individual account* in the program. I would like to be sure the Commission is aware that, quite often, certain individual accounts in a CTA's program have drawdowns which are far larger (sometimes by a factor of 2X) than the worst drawdown appearing in the composite performance table. Thus, valuable information on volatility will not be readily available to the investing public, and this proposed change will cause prospective customers to be mislead as to the actual past volatility of some CTA programs. I suggest that both Worst and Composite Drawdowns be presented.

Dear Ms. Webb:

I am a private investor. I have considerable experience participating in the futures markets through the use of accounts managed by commodity trading advisors (CTAs) registered with the Commission. I presently use over two dozen CTAs to trade my accounts. I am making my comments on the basis of my education, knowledge and experience in these matters. In addition to the extensive analysis work I have done for many years regarding selecting and monitoring the performance of the CTAs I have hired, I am also a Fellow of the Society of Actuaries and for many years I worked as a Vice President and

Actuary for several Insurance Companies. Therefore, I hope the Commission will find my perspective on the above-referenced rule proposal helpful in its deliberations, even though they are somewhat late.

Assessing the volatility of a CTA's program is one of the most important aspects of selecting an appropriate CTA. A prudent investor will reject CTAs which they find to have excessive volatility relative to their risk tolerance. It should be a "red flag" if a CTA program contains accounts with widely disparate results. In my evaluation process, I analyze carefully both the monthly rates-of-return and the worst monthly drawdown figures for a program. I often ask for (from the CTA) data on all of the individual accounts in a program, so that I can analyze disparate performance amongst the accounts over time.

For the general public, the worst monthly drawdown amount based upon the worst individual account in a program is the only available information regarding disparate account performance and possible non-systematic spikes in a CTA's program. Moreover, spikes which affect only a minority of the accounts in a program will be masked by the averaging process of preparing a composite table. That is, composite rates-of-return are averages from amongst a large group of accounts and, thus, do not reveal important information on volatility that could easily impact any client account in a CTA's program.

I make these statements of fact on the basis of hard-learned personal experience. When I have compared my own account results to the performance figures reported by my CTAs in their performance tables *for the same program,* often, I have had percentage losses in a particular month as much as *double* that of what my CTAs reported in their composite tables as the rates-of-return for the same month. That is, over the years this has happened to me many times. Therefore, regardless of the Commission may change its rules, I will continue to insist on receiving this information from my CTAs. However, most clients have accounts far smaller than mine and, thus, may not be successful in obtaining this information.

In the past I have sometimes waived requiring this type of information where, I felt it was needed because the CTA said it was difficult. In each case I have come to regret it without exception. I will refuse to do business with CTAs that are secretive about differing performance between accounts. One third of my accounts experience significantly worse experience than the published numbers, that can only be explained by different trades.

In discussing the wide differences I have observed between my own individual account and the composite figures reported by my CTAs, I learned from my CTAs that there are several reasons for the differences: i.) Different Trades and sizes executed between accounts, ii.) interest income, iii.) fee and commission structure, iv.) negative incentive fee accrual, and v.) some failures to follow CFTC requirements. Items ii & iii are easy to Understand and make proforma adjustments. Item 'i' is the most serious and unsolvable problem, and is best addressed by reporting both the worst and average account. Items 'iv' & 'v' be worthy of some special consideration by the Commission.

Item i) Different accounts get different trades, because of rounding of executed contracts, brokers not being able to fill trades, especially on limit and other special orders. Hence one account may get more of a losing trade, less or none of a Winning trade. Where the trader gets only a partial fill, the allocation comes back to the trader, after the market has moved, for correction. Sometimes the allocation is by account number, so the high account number loses the whole trade, instead of just part of it. This can impact large accounts as well as small accounts. The CFTC should require advisors to report worst drawdown based on the average account and the Worst account. This gives an indication of the problem for this advisor. Many advisors are ignoring the worst account rule, and this will become obvious when they have to report both.

The negative incentive fee accrual can be the cause of disparate returns amongst the accounts in a composite performance table, as an incentive fee may amount to 30 percent of profits, or more. As I understand it, under the Commission's requirements a negative fee accrual may be made for an individual account *if there are positive fees accrued in prior months that must be rebated by the CTA in a subsequent loss month*, under the agreement between the CTA and its customer. Since not all accounts in a CTA's program are likely to have entered the program during the same month, different accounts will have different amounts of previously-accrued positive incentive fees for purposes of negative accrual (the rebate). That is, some accounts may have no prior-accrued fees at all for rebate purposes, some will have only some and some will have sufficient prior-accrued fees to make a full negative accrual. Therefore, the result of such disparate negative accruals can be materially different rates-of-return (negative ones) amongst the accounts in a program. (Remember there are many other reasons possible, too.) For example, assuming a 30 percent incentive fee rate and a 20 percent loss month, a negative fee accrual can reduce a percentage loss by a material amount, *e.g.*, from 20 percent to 14 percent, in this example. Therefore, the negative incentive fee accrual, even when calculated correctly, can cause material disparities in the worst drawdowns amongst the accounts in the same composite. I have also noted some compliance problems.

I have also observed that it is not uncommon for CTAs to fail to follow the CFTC's rules with the result that volatility is masked even more than it would be if the rules were correctly followed. Two ways come to mind. First, I have encountered some CTAs who have provided an improper negative fee accrual for their accounts. I say this because it was clear from the monthly rates-of-return that most of the accounts had no prior month earned incentive fees to rebate. In discussing this with the particular CTAs, I get the impression that they do not understand how correctly to make the negative fee accrual and they claimed that their calculations had been reviewed and approved by auditors from the National Futures Association. Second, I have also encountered some CTAs who have simply chosen to use the worst monthly rate-of-return from the composite table, rather than use the rate-of-return from the worst individual account. I know this to be a fact, because my own account in the CTAs program performed far worse than what the CTA had reported as his worst monthly drawdown. If my account had been the worst-performing one in the program, I should have observed my account's negative rate-of-return used as the program's worst monthly drawdown. I recognize that the two items I just discussed are not part of the rule proposal, but they are important compliance matters for the CFTC to consider.

In conclusion, it is my view that the above-referenced proposed rule change would be a step backward in providing useful information to the prospective clients of CTAs.

Sincerely,

Harry Ploss