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OFFICE OF THE SECRETARIAT

September 14, 1998

Jean A. Webb, Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, DC 20581

COMMENT

SEP 15 12 10 PM '98  
COMMODITY FUTURES  
TRADING COMMISSION  
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Re: Performance Data and Disclosure for Commodity  
Trading Advisors and Commodity Pools

Dear Ms. Webb:

This letter is in response to the Commission's request for comments on the above-referenced Concept Release, published in the Federal Register (63 Fed. Reg. 33297, June 18, 1998).

John W. Henry & Company, Inc. ("JWH<sup>®</sup>") is a registered commodity trading advisor ("CTA") managing over \$2 billion in equity for leading money center banks, brokerage firms, retirement plans, insurance companies, multinational corporations, private banks and family offices in the Americas, Europe and Asia. JWH is also registered as a commodity pool operator ("CPO") and it has several affiliates registered as CTAs and/or CPOs. The presentation of performance results is crucial to the ability of an investment manager to market itself and its products successfully, and to the ability of clients to evaluate their investment and its contribution to their portfolios. Accordingly, the Concept Release and the issues it discusses are relevant and important to JWH, its affiliates and their clients.

Performance information, in our view, should accordingly be accurate, verifiable, comparable, and readily understandable. In some cases, these desiderata may conflict, and choices must be made of the criteria to emphasize. JWH commends the Commission and its staff for addressing the issues related to the calculation and presentation of performance results, and particularly the notional funding issue raised by the National Futures Association's proposed Compliance Rules 2-29(b)(5) and 2-34 and the related Interpretive Notice (together the "NFA Proposal").

## The NFA Proposal

As a general matter, JWH believes that the NFA Proposal, modified as proposed below, should be treated separately from the other, broader-ranging performance issues raised in the Concept Release. The Concept Release goes well beyond the issues addressed in the NFA Proposal. While the issues surrounding performance reporting for notionally funded accounts have been discussed at length in the managed funds industry since 1987, the other issues have not been the subject of comparable review and discussion. Since less than three years have passed since the Commission adopted amendments to its Part 4 rules that constituted their most extensive revision since their promulgation in 1981, JWH believes that more time is necessary for thorough review of these other issues by members of the industry and their professional advisors. Enhanced comparability among CTA performance records was a primary reason advanced in 1994-1995 for adoption of the capsule approach to performance presentations. JWH believes that any modifications to existing requirements and practice should be evaluated by comparing them to performance standards developed in other areas of investment management. This will further the goal of enhancing comparability of managers' performance, which will become more important as investment management converges across industries and traditional securities/futures distinctions continue to erode.

JWH supports adoption of the NFA proposal. We believe that the NFA Proposal is particularly deserving of support by us and adoption by the Commission because of its contribution to enhancing accuracy, comparability, and ease of understanding of performance results. In our experience, notional funding is, and has been, an approach to account funding implemented by clients rather than one actively solicited by CTAs. Since 1987, when Advisory 87-2 was issued to address the notional funding issue, the manner in which CTAs present their performance history has been modified frequently: the "two table" approach utilized after the issuance of Advisory 87-2; the fully-funded subset method; and, more recently, capsule performance presentations. Each of these changes was made for the purpose of increasing the accuracy of performance presentation, but tended also to diminish comparability and ease of investor understanding. These changes have complicated the explanation of performance presentations and have arguably rendered comparisons among managers - particularly those not subject to regulation by the Commission - more difficult. The complexity and variability of requirements in this area contributed significantly to adoption of JWH's policy of no longer accepting notional funds.

JWH believes that acceptance of the NFA Proposal would resolve the performance presentation issue related to notional funding in a manner that simplifies this issue for potential investors. Our view is based on the belief that funding decisions by a client do not influence an advisor's management decisions, and that funding level-based performance information does not provide useful information to a client on the relative merits of management skill in generating returns. JWH believes that the costs of presenting partial funding level drawdown results outweigh any potential benefit.

Partially funded account performance information would be costly to compile, confusing to investors, and at odds with the performance presentation requirements for other types of investment managers. The most significant drawback of this approach is likely to be the confusion this type of information generates for investors, who may not understand the data presented or what they mean when comparing information across managers without a significant increase in explanatory text and notes. Such information is unlikely to lead to clearer comparisons; more information is not better disclosure if it does not produce valid comparisons.

There are several elements of the NFA Proposal that should be clarified to confirm that they apply only to CTAs that manage partially funded accounts. For example, Section 2-34(a) of the proposed compliance rule is intended to apply to all CTAs, but it should not apply to CTAs that only manage accounts that do not involve partial funding. Section 2-34(a) should contain the same language as Section 2-34(b) to limit its requirements to CTAs that solicit and accept partially funded accounts. It should also be confirmed that the use of letters of commitment in proper form constitutes full funding for an account, as has been the case since Advisory 87-2 was issued.

The NFA Proposal contains some issues that could complicate CTA performance disclosure. For example, a CTA would be required to provide a copy of its advisory agreement for each client to the client's FCM. The stated rationale for this point is that FCMs can use such information in determining whether or not to accept a client who wants to open a notionally funded account, and on what credit terms. However, the requirement is not limited to partial funding situations. It should be limited to those accounts. JWH also urges that the Commission consider requiring here only disclosure to FCMs of those portions of an advisory agreement that bear on funding issues. As an alternative to furnishing such portions of an advisory agreement to FCMs, a CTA could be permitted to furnish a certification to FCMs stating the relevant funding terms. The certification alternative could be elected at the option of the CTA, and would be subject to verification in NFA audits. There is no reason why specific contractual terms other than those related to funding would be of concern to FCMs. In addition, providing all of an advisory agreement to FCMs could require the disclosure of proprietary information to FCMs, some of which have affiliates competing with CTAs. This proposed requirement should also be clarified to state that it does not require termination of the customary practice of providing a power of attorney form to the FCM, rather than a complete copy of the CTA agreement with each client, so that a straightforward and simple statement of trading authority is available for the FCM's records. Under Section 2-34(a), all CTAs also would be required to disclose in writing to clients the factors considered in determining minimum account size for its programs. This determination often involves proprietary and discretionary information. The proposal should be modified to state that a general description of such factors will suffice, but be required even then only for those CTAs that solicit and accept notionally funded accounts.

## Other Issues

The proposed expansion of the capsule disclosure format to include additional disclosure of drawdowns at different funding levels, such as in tabular format, is also problematic, in our opinion. These types of additional disclosure would negate some of the benefits intended to be achieved in 1995 when the capsule format was adopted to streamline performance disclosure. One key variable that influences the ability of a manager to generate returns is the degree of leverage employed. Margin often is also a basic risk management technique. JWH is concerned that mandatory disclosure of estimates of the range of amounts of equity associated with margin will reveal proprietary information about the management of accounts. In addition, for many CTAs, there may not be a common or single level of margin to equity requirements. Some CTAs employ margin on a dynamic basis, so that margin may not change dramatically in a short period of time but may be reviewed constantly and modified periodically. Consequently, disclosure of margin to equity ratios, even when expressed as a range of percentages, could be misleading and difficult to compare across firms. Some CTAs - particularly smaller firms - may not calculate or monitor margin levels themselves, and some CTAs also may not consider or employ margin specifically as a risk management tool. JWH believes that margin should be regarded as a FCM risk control measure. Moreover, the use of margin as an indicator of risk is not necessarily reliable. Studies have shown that short-term volatility may increase significantly with only a small change in margin. In cases where margin amounts only change slowly, margin may over- or under-represent the risk associated with a particular market. JWH consequently questions whether margin to equity ratio provides a good measure of the risk associated with a fund or account.

JWH believes that any changes in performance presentations that result from the Concept Release should be prospective only. CTAs should not retroactively have to recreate performance presentations. This was required when the notional funds issue was first addressed by the Commission in 1987, and again in 1995 when the capsule format was adopted. We question the value of another significant change in performance presentation format after only three years of experience with a new format. Each of these changes imposes costs on CTAs, and those costs are particularly burdensome to smaller firms. We are not aware of any regulatory or compliance problems that have arisen as a result of the 1995 performance reporting format.

In the fund of funds area, a complex chart is proposed to disclose potential exposure to drawdowns. We question the desirability of implementing of a 5% threshold for inclusion of funds in such a table. We favor use of a 10% level, since that has been the Commission staff's traditional standard of materiality. Moreover, "drawdowns" are essentially a concept specific to the managed futures industry. In the fund of funds context, comparable data for non-managed futures products may not be available, so that undue disclosure emphasis could be placed on this single factor.


The proposal requests comments on whether a time period longer than five years is superior for disclosure purposes. It also proposes reduction in the required time period for presentation of monthly performance data. JWH supports both of these proposals. While monthly data could be required to be made available on client demand, or included in a disclosure document at the option of a CTA, annual data should otherwise be sufficient. We believe that presentation of a track record since inception provides the most complete picture of an advisor's ability to manage accounts under a variety of market conditions.

The proposal also discusses expanding disclosure of the number of worst drawdown periods from a single worst case to "three or possibly six," based on the view that "extreme market events do not always occur within a five-year time frame. Often the time interval between market events is ten years or more." Concern is expressed that a five year disclosure period enables some CTAs and CPOs to avoid disclosing their greatest drawdowns. JWH's view, as stated above, is that presentation of a complete track record constitutes the best disclosure. If clients believe that only a shorter, more recent period is the most relevant performance disclosure, they can limit their review to that time segment. JWH believes that if presentation of a track record since inception is required, as it advocates, mandatory disclosure of the single worst drawdown is sufficient and would prevent masking of a CTA's or CPO's worst drawdown. Because of the extensive labor involved in identifying individual accounts' particular drawdown histories, JWH urges that any additional disclosure requirement for worst drawdowns be permitted to be made on a composite basis, rather than on an individual account basis.

CTAs have not historically been required to provide reports to their investors, unlike CPOs. The release proposes that CTAs for the first time provide periodic reports to their clients. JWH supports this change, but such reports should be limited to managed accounts, and not be applicable to pools where the CPO makes the relevant calculations, sets account size and is already required under Commission Rule 4.22 to provide reports to pool investors.

If the Commission or its staff believes that further discussion of any of the issues addressed in this letter would be useful, we would be happy to participate in the further development of performance disclosure rules that serve the goals of accuracy, verifiability, comparability, and understandability.

Sincerely yours,



David M. Kozak