Commodity Futures Trading Commission
Roundtable of CPO and CTA Issues
September 19, 2002

Introductory Remarks by George E. Crapple,
Co-Chairman and Co-CEO, Millburn Ridgefield Corporation

Agenda Item III B: Communications with prospective participants – CFTC rules requiring CPO or CTA to provide disclosure document before directly or indirectly soliciting prospective participant.

CFTC rules require delivery of a disclosure document before directly or indirectly soliciting a potential investor. Rule 4.21 applies to CPOs and Rule 4.31 to CTAs. The rules apply to the solicitation of managed accounts and to public and private offerings of pools, with the exception of offerings of interests in Rule 4.7 pools to "qualified eligible participants" to whom the disclosure document delivery requirement does not apply. The rules permit a CPO to deliver a shorter "profile" document containing specified information prior to providing prospective investors with the disclosure document. Because any other communication is susceptible of being interpreted as a direct or indirect solicitation, the rules effectively eliminate non-disclosure document communications unless accompanied or preceded by a disclosure document.

Questions for consideration of the Roundtable include: how do the CFTC rules compare with SEC rules for solicitation of investors; and what are the CFTC rules intended to protect against?

In the case of public offerings of any security which is not an interest in a commodity pool, the SEC allows tombstone advertisements which may contain specified factual information. These communications are designed to locate potential investors who may be interested in the offering and receiving more information. This limited sort of communication would be allowed for public offerings of commodity pools but for the CFTC rules. If this were an SEC rather than CFTC roundtable, I would advocate liberalization of the tombstone rules to permit factual, balanced, non-misleading and non-fraudulent information. The SEC rules also provide for use of "red herring" preliminary prospectuses and delivery of the final prospectus with confirmation of the order.

The SEC has no specific requirements as to content or delivery of information in the case of private placements to accredited investors. Issuers have Rule 10b(5) anti-fraud liability. As noted above, CFTC rules do not require a disclosure document in the case of qualified eligible participants in Rule 4.7 pools, and the CFTC permits a CPO to give a potential investor a summary "profile" document containing only key information about a pool prior to providing a disclosure document. Like a disclosure document, the profile must be filed with the CFTC before use. The profile seems quite heavy on notices, risks and warnings and light on the information which might help locate potentially interested investors. In an effort to insure that no good risk goes undisclosed, the profile is really a mini-disclosure document. In a totally unscientific and non-random poll I have taken in connection with this Roundtable, I have failed to unearth any use of "profile" documents. In any event, except for Rule 4.7 pools, the rules governing private offerings of commodity pools are more restrictive than for the offering of any other type of security, and in the case of public offerings of pools, even narrow tombstone advertising is prohibited.

What are the CFTC rules intended to protect against? Is the prospective investor in a commodity pool likely to be so swept away by preliminary factual, balanced, non-misleading and non-fraudulent information that he will cast aside the disclosure document and sign the subscription agreement as soon as he can get his hands on it? The drafters of preliminary marketing materials are not likely to be so eloquent or convincing. Is there something peculiar to offerings of futures pools which requires rules more stringent than all other types of securities offerings, such as being especially risky? I think the bear market in stocks has laid to rest any idea that managed futures investments are more risky than equities. The full panoply of protections offered to investors under the Investment Company Act of 1940 – for example, leverage limits and diversification requirements – permitted mutual funds investing in nothing but dot coms. There seems no rationale for singling out futures pools. When an investor receives the disclosure document before committing to an investment, there is no justification for different treatment than other securities offerings.

What information should be allowed in communications which precede delivery of the disclosure document? My premise is that the information required in disclosure documents is generally useful and that preliminary information will be considered by the

potential investor in the context of the disclosure document. I would therefore propose that any factual, balanced, non-misleading, non-fraudulent information about the offering of a commodity pool or account which is otherwise permissible under the federal securities laws be permitted. This would automatically result in separate standards for public and private offerings and set a "core principles" type of standard for managed accounts. The idea of balancing language has long been required for disclosure documents and marketing materials, and it can be employed usefully for preliminary materials. If materials do not meet this suggested test, liability would accrue. Communications which now often accompany the disclosure document are not normally subject to filing requirements, and I see no reason for pre-filing materials which precede the disclosure document. If they are unbalanced, misleading or fraudulent, the sponsor will be liable.

Of course, the discussion of preliminary communications assumes that a disclosure document will be delivered. In the case of public and private pools and managed accounts, a signature is required, unlike purchasing stock by calling a broker. The receipt of the disclosure document must be acknowledged in writing. There will be no question that the investor has had the opportunity to read the disclosure document before committing to the investment. Whether it is actually read is no more or less knowable than in the case of prospectuses generally. Modifying Rules 4.21 and 4.31 would not change the rule that a disclosure document must be delivered and acknowledged.

In the case of Registered Investment Advisers under the Investment Advisers Act of 1940, the adviser's disclosure document must be delivered at least 48 hours prior to entering into an advisory agreement. Since there must be written acknowledgement of receipt of a pool (or CTA) disclosure document and a signed subscription agreement, the 48-hour period seems unnecessary in this context.

What benefits would accrue for the proposed modifications to the rules? One is regulatory. An increase in consistency between SEC and CFTC rules would be achieved. A second is cost savings. Marketing expenses are normally paid by pools, and marketing documents are very expensive. The ability to obtain indications of interest in an offering before providing the main document would be a material reduction of costs to investors. This benefit can be achieved without any diminution of customer protection.