COMMODITY FUTURES TRADING COMMISSION
2033 K Street, NW, Washington, DC 20581
(202) 254 - 8955
(202) 254 - 8010 Facsimile

93-84

DIVISION OF
TRADING AND MARKETS

August 20, 1993

Re: Relief from Rule 4.31(a)(3)

Dear :

This is in response to your letter dated June 21, 1993, as supplemented by telephone conversations with Division staff, wherein you request on behalf of "X", a registered commodity trading advisor ("CTA"), relief from Rule 4.31(a)(3)[1/] such that "X" may exclude certain past performance from its Disclosure Document.

From the representations made in your letter, as supplemented, we understand the facts to be as follows:

> From time to time, [you] test new trading strategies prior to marketing them to the general public. The purpose of the testing is to determine whether or not the strategy is a viable product and to obtain a historical performance record should [you] decide to offer the strategy. Usually the funds used for the test strategies are proprietary monies, however, they may on occasion come from an outside source. Any outside sources would be sophisticated, high net worth investors.

The past performance record of a trading strategy not offered to clients of a CTA is not required to be disclosed under Rule 4.31(a)(3). This is because Rule 4.31(a)(3) requires disclosure of the actual past performance record of all accounts directed by the CTA. In this regard, the Commission has stated that, because Rule 4.31(a)(3) requires disclosure of the performance of clients' accounts, as used in the context of the past performance disclosure requirements, the term "clients" applies

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1/ Commission rules referred to herein are found at 17 C.F.R. Ch. I (1993).

to persons other than the CTA (or the principals thereof) who presents that past performance in its Disclosure Document. See 46 Fed. Reg. 26004, 26005 (May 8, 1981). Therefore, the past performance of a strategy traded by "X" exclusively with the funds of "X" and its principals is not required to be disclosed in "X"'s Disclosure Document pursuant to Rule 4.31(a)(3) even if "X" should subsequently offer the strategy to its clients.[2/]

By letter dated July 26, 1993, the Division granted relief to "A", the general partner of a partnership he intends to form (the "Partnership"), such that the Partnership would not be deemed a pool within the purview of Rule 4.10(d) and that "A", as the general partner, would not be the CPO thereof. As represented by "A", the purpose of the Partnership is to enable "X" to test a trading strategy (the "Strategy") prior to marketing and making the Strategy available to its clients. Although the Partnership contains funds other than those of "X" and its principals, based upon "A"'s representations concerning the non-"X" limited partners ("A"'s wife and "B", who has been a friend of "A"'s for over 30 years and who is a founding partner of "C" & "B", a registered investment adviser that manages assets in excess of $5 billion), the Division will not recommend that the Commission take any enforcement action against "X" if it fails to include the performance of the Partnership in its Disclosure Document.[3/]

You have also inquired as to whether "X" must disclose its past performance record using any other trading strategies which are traded with funds other than or in addition to those of "X" and its principals. In order to respond to this inquiry we will require information concerning the actual sources of funds used in trading. Accordingly, we ask that you seek further guidance from us when "X" is able to specifically identify the relevant sources of funds used in the testing of new trading strategies prior to marketing them to the general public.

You should be aware that the position taken in this letter does not excuse "X" from compliance with any other applicable requirements contained in the Commodity Exchange Act (the "Act"), 7 U.S.C. §1 et seq. (1988 & Supp. IV 1992), or the regulations

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[2/] However, pursuant to Rule 4.31(g), such performance may be required to be disclosed if it is material in the context of the advisory services being offered, e.g., if the performance showed negative results.

[3/] But see n.2, above. We are not at this time addressing the question whether the Partnership's performance would be required to be disclosed if "X" were offering services involving use of the Strategy to clients.

promulgated thereunder. For example, it remains subject to the antifraud provisions of Section 4o of the Act, 7 U.S.C. § 6o (1988 & Supp. IV 1992), to the reporting requirements for traders set forth in Parts 15, 18 and 19 of the regulations, and to all other provisions of Part 4 including, in particular, Rule 4.31(a)(3). Also, this position is applicable solely with respect to the past performance record of the Partnership.

The position taken in this letter is based upon the representations that have been made to us. Any different, changed or omitted facts or conditions might require us to reach a different conclusion. In this connection, we request that you notify us immediately in the event that the activities of "X" change in any way from those as represented to us. Further, this letter represents the position of the Division of Trading and Markets only. It does not necessarily represent the views of the Commission or any other office or division of the Commission.

If you have any questions concerning this correspondence, please contact me or Mary Cademartori, an attorney on my staff, at (202) 254-8955.

Very truly yours,

Susan C. Ervin
Chief Counsel