(a) Within 24 months after the effective date of this AD, inspect the manufacture date code on all hoses listed in Table 1 of this AD, in accordance with the Accomplishment Instructions of the applicable Boeing alert service bulletins (ASB) contained in Table 1 of this AD. Table 1 follows:

TABLE 1.—APPLICABLE HOSE P/NS

Airplane model	Boeing hose p/n	Titeflex PMA p/n	Used for—	Applicable alert service bulletin—
(1) 737–300, –400, and –500 airplanes.	S312N512–5, S312N512–6, BACH5R0110YP, BACH5S0110XN.	113701–5, 113701–6	Engine and cargo compartment fire extinguishing bottles.	737–26A1108, Revision 1, dated June 27, 2002.
(2) 737–600, –700, –700C, –800, and –900 airplanes.	S316A001–1, S316A001–2, S312N512–15, S312N512–17, S312N512–18, BACH5R0110YP, BACH5S0110XN.	115398–1, 115398–2, 113701–15, 113701–17, 113701–18.	Engine, auxiliary power unit (APU), and cargo compartment fire extinguishing bottles, and wing-to-strut fuel hoses.	737–26A1109, Revision 1, dated November 7, 2002.
(3) 747–400 airplanes	BACH5R0080YY, BACH5R0140YU, BACH5S0140XT, BACH5R0186YY, BACH5R0186XX, BACH5S0080XX, BACH5S0080YY, BACH5S0110XN.	....	Forward cargo and main deck cargo compartment fire extinguishing bottles.	747–26A2269, Revision 1, dated June 6, 2002.
(4) 757–200 airplanes	S312N512–1, S312N512–2, S312N512–3, S312N512–4, BACH5R0110YP, BACH5S0110XN.	113701–1, 113701–2, 113701–3, 113701–4.	Engine, APU, and cargo compartment fire extinguishing bottles.	757–26A0043, Revision 1, dated November 14, 2002.
(5) 757–300 airplanes	S312N512–1, S312N512–2, S312N512–3, S312N512–4, BACH5R0110YP, BACH5S0074XN.	113701–1, 113701–2, 113701–3, 113701–4.	Engine and cargo compartment fire extinguishing bottles.	757–26A0044, Revision 1, dated November 14, 2002.
(6) 767–200, –300, and –300F airplanes.	BACH5R0085YU, BACH5R0140YU, BACH5S0077XT, BACH5S0140XT, BACH5S0184XX, BACH5R0127YY.	....	Cargo compartment fire extinguishing bottles.	767–26A0121, dated December 19, 2001.

(b) If the hose manufacture date code is before 11/99 or after 1/01, or if the manufacture date is 11/99 through 1/01 and there is a permanent white dot on the ID band, no further action is required for that hose.

(c) If the hose manufacture date code is 11/99 through 1/01 inclusive and there is no permanent white dot on the ID band, replace the hose with a serviceable hose or perform an indirect conductive inspection/test for proper heat treat, in accordance with the accomplishment instructions of the applicable ASB listed in Table 1 of this AD.

(d) Replace the hose with a serviceable hose if any B-nut is improperly heat treated.

Credit for Previous Inspections

(e) Previous inspections performed using ASB 737–26A1108, dated November 15, 2001, ASB 737–26A1109, dated November 15, 2001, ASB 747–26A2269, dated November 1, 2001, ASB 757–26A0043, dated November 15, 2001, and ASB 757–26A0044, dated November 15, 2001, comply with the inspection requirements of this AD.

Alternative Methods of Compliance

(f) An alternative method of compliance or adjustment of the compliance time that provides an acceptable level of safety may be used if approved by the Manager, Boston Aircraft Certification Office (ACO). Operators must submit their request through an appropriate FAA Principal Maintenance Inspector, who may add comments and then send it to the Manager, Boston ACO.

Note 2: Information concerning the existence of approved alternative methods of compliance with this airworthiness directive, if any, may be obtained from the Boston ACO.

Special Flight Permits

(g) Special flight permits may be issued in accordance with §§ 21.197 and 21.199 of the Federal Aviation Regulations (14 CFR 21.197 and 21.199) to operate the airplane to a location where the requirements of this AD can be done.

Issued in Burlington, Massachusetts, on March 6, 2003.

Jay J. Pardee,

Manager, Engine and Propeller Directorate, Aircraft Certification Service.

[FR Doc. 03–6043 Filed 3–12–03; 8:45 am]

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COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 4

Performance Data and Disclosure for Commodity Trading Advisors

AGENCY: Commodity Futures Trading Commission.

ACTION: Proposed rules.

SUMMARY: The Commodity Futures Trading Commission (''CFTC'' or ''Commission'') is proposing to amend its rules relating to the computation and presentation of rate of return information and other disclosures concerning partially-funded accounts managed by commodity trading advisors (''CTAs'').

DATES: Comments must be received by April 14, 2003.

ADDRESSES: Interested persons should submit their views and comments to Jean A. Webb, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581. In addition, comments may be sent by facsimile transmission to (202) 418–5543, or by

electronic mail to *secretary@cftc.gov.* Reference should be made to ''Performance Data and Disclosure for Commodity Trading Advisors.''

FOR FURTHER INFORMATION CONTACT: Robert B. Wasserman, Associate Director, (202) 418–5092, electronic mail: *rwasserman@cftc.gov*, or Eileen R. Chotiner, Futures Trading Specialist, (202) 418–5467, electronic mail: *echotiner@cftc.gov*, Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, 1155 21st Street, NW., Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

I. Background

The Commission is proposing to amend several of its rules [1] affecting the computation and presentation of rate of return information and other disclosures by CTAs to prospective clients. The proposed amendments will enable CTAs to disclose past performance as computed on the basis of the client's nominal account size (the amount upon which the CTA bases its trading decisions) rather than on the basis of the actual funds the client has placed in an account subject to the CTA's control. The amendments will affect past performance disclosure made by CTAs to prospective clients, and will not affect the manner in which information is provided to existing clients. Existing clients will continue to receive information on the status of their own accounts on an actual cash basis.[2]

On August 2, 1999, the Commission published in the **Federal Register** [3] proposed rules regarding the computation and presentation of rate of return information and other disclosures concerning past performance of accounts over which the CTA has had trading authority.[4] No final action was taken at that time. Now, due to the passage of time, intervening legislative and other developments, including reevaluation of certain of the issues involved, the Commission is reproposing these amendments.

II. Proposed Amendments to Commission Regulations 4.25, 4.33, 4.34 and 4.35

A. Rate of Return Computation

This proposal addresses how to measure advisors' rates of return in a margin- and leverage-based industry. From the CTA's perspective, trading is the same for all accounts in a program, regardless of the amount of actual funds. The use of margin, however, allows clients to fund accounts with much less in actual funds than the account size that they have agreed to have the CTA trade. Determination of the amount a client deposits with an FCM is between the FCM and the client—the CTA is not part of this decision, nor does it affect the CTA's level of trading for the client's account. Each existing CTA client will receive from its FCM reports of the amount of actual funds in the account, the profits or losses that occur, fees charged, and notice of any margin calls that may be necessary.

The rules that the Commission is proposing to revise apply to the disclosure of the CTA's past performance to prospective clients. The difficulty in basing such performance on actual funding levels arises primarily from the use of margin, which permits actual funding levels that may be so minimal as to make a return calculated on that basis greatly distorted. In addition, clients generally may open accounts with an FCM of their own choosing and clients in the same trading program may, in fact, have widely divergent amounts of actual funds supporting the same level of trading. In order to allow CTAs to present to prospective clients composite performance results that will be consistent for the accounts within the program, the Commission is proposing that the basis for the rate of return calculation be the amount on which the CTA is making its trading decisions—the nominal account size.

1. Brief History of Methods Used To Compute Rates of Return

The Commission first required disclosure of the past performance of CTAs in 1981.[5] The rate of return for a period for a particular trading program was defined as the net performance [6] for that period divided by the net asset value at the beginning of the period.[7] At that time, the practice of partial funding was not common; clients generally deposited in their accounts with FCMs an amount equal to the amount that the CTA and its customer had agreed would determine the level of trading, which subsequently became known as the ''Nominal Account Size.''

In later years, Commission staff became aware that some CTA clients were not depositing the full nominal account size in their FCM accounts. This led the Division of Trading and Markets [8] to issue Advisory 87–2, which stated that only funds under the control of the CTA (''Actual Funds'') could be included in beginning net asset value (''BNAV'').[9] Advisory 87–2 stated that ''funds which the client has promised orally to provide upon request'' (there described as ''notional'' funds) could not be included in BNAV.

After Advisory 87–2 was issued, Commission staff were frequently apprised by industry participants of their concerns regarding the possible distortions to rates of return calculated based on actual funds rather than the account size, designated by the client, upon which the CTA made its trading decisions.[10] In 1993, the Commission issued Advisory 93–13, in an effort to alleviate these concerns and to reach a compromise between the actual funds and the ''notional'' funds methods of computing performance.[11]

Advisory 93–13 permitted CTAs to disclose, as their past performance, the

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[1] Commission rules cited herein are found at 17 CFR Ch. I (2002).

[2] Commission Rule 1.33 sets forth the requirements applicable to futures commission merchants (''FCMs'') with respect to reporting to their customers. Commission rules cited herein are found at 17 CFR Ch. I (2002).

[3] See 64 FR 41843 (August 2, 1999).

[4] Those proposed amendments developed out of rules proposed by National Futures Association (''NFA'') to permit CTAs to disclose past performance as computed on the basis of the client's nominal account size (the amount upon which the CTA bases its trading), rather than on the basis of the actual funds the client has placed in accounts subject to the CTA's control. The NFA proposal was also the subject of a concept release published by the Commission in June 1998 that discussed a number of possible enhancements and alternatives to the NFA proposal and sought public comment on those issues. See 63 FR 33297 (June 18, 1998).

[5] See 46 FR 26005, 26009 (May 8, 1981). Pursuant to the original Part 4 disclosure rules adopted in 1979, CTAs were permitted, but not required, to disclose their past performance in accordance with the format specified for commodity pool performance. 44 FR 1918, 1923 (January 8, 1979).

[6] Commission Rule 4.35(a)(6)(i)(D) currently specifies that net performance represents the change in the net asset value net of additions, withdrawals, redemptions, fees and expenses. Commission Rule 4.10(b) currently defines ''net asset value'' as ''total assets minus total liabilities, determined in accord with generally accepted accounting principles, with each position in a commodity interest accounted for at fair market value.''

[7] Commission Rule 4.35(a)(6)(i)(A).

[8] Following the Commission's reorganization in July 2001, the Division of Trading and Markets' role with respect to CPOs and CTAs is now carried out by the Division of Clearing and Intermediary Oversight.

[9] CFTC Advisory 87–2 [1986–87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,624 (June 2, 1987). Advisory 87–2 specified that funds contained in a commodity trading account over which the CTA has been given trading authority must be included in BNAV, and set forth the conditions under which funds contained in any other type of account carried with the FCM could be included in BNAV.

[10] These concerns were among the issues addressed by the Managed Futures Subcommittee of the Commission's Regulatory Coordination Advisory Committee, which existed from 1990 to 1995.

[11] CFTC Advisory 93–13, 58 FR 8226 (February 12, 1993). The term ''nominal account size'' was introduced in Advisory 93–13.

rate of return of a ''fully-funded subset'' of their accounts, provided that two standards were met.[12] The first standard required that the aggregate of the actual funds for the fully-funded accounts be at least ten percent of the aggregate of the nominal account sizes of the accounts included in the program. The second standard required that the gross trading profit ratio for the subset be ''materially the same'' as the gross trading profit ratio for the aggregate.[13] In other words, the performance of the subset had to be, in fact, representative of the performance of the aggregate, considered on the basis of the nominal account sizes.

For example, if the CTA had 15 accounts, three of which were fully funded, the CTA could treat the rate of return of the three fully-funded accounts as representative of all 15 accounts as long as the two tests were met. Thus, if all 15 accounts had nominal account sizes of $100,000, the first standard would be met by the three fully-funded accounts—*i.e.*, $300,000/$1,500,000 is twenty percent, which exceeds the ten percent minimum. This test could also be met by one sufficiently large fully-funded account. If each of the 15 accounts experienced gross profits of $10,000, the gross trading profits ratio of the subset would be the same as the gross trading profits ratio of the aggregate, meeting the second test. Advisory 93–13 explicitly permitted a number of adjustments and exceptions to these two standards. For example, an account could use the fully-funded subset method despite failures to meet the ten percent test ''for a limited number of periods.''

Advisory 93–13 ameliorated disclosure problems for those CTAs that had sufficiently fully-funded accounts to meet the ten percent test. Commission staff nonetheless have increasingly encountered circumstances where CTAs have lacked (or lost) sufficient fully-funded accounts, but where disclosure based on actual funds levels would be misleading or confusing.

2. Proposed Changes to Commission Regulation 4.35(a)(6)(i) To Adopt Nominal Account Size as the Denominator in the Rate of Return Calculation

Existing Commission Regulation 4.35(a)(6)(i) requires that, in presenting past performance to prospective participants, the rate of return for a period be calculated by dividing net performance by the beginning net asset value. The proposed amendment to Regulation 4.35(a)(6)(i) would require that the rate of return be computed by dividing net performance by the nominal account size at the beginning of the period.[14] It is the proposed change in the denominator of the rate of return computation—from net asset value to nominal account size—that underlies the framework for performance presentation set forth in the rule proposal.

The Commission recognizes that each of the methods that has been used or proposed–the actual funds method, the fully-funded subset method, and the nominal account size method—has flaws. For example, under the actual funds method, two accounts with the same nominal account size, which hold the same market positions and number of contracts, and which experience the same gains or losses, would show different performance if the clients choose to fund their accounts differently.[15] Further, the CTA's presentation of its past performance for accounts in the same trading program could combine, in the same actual funds-based performance table, accounts with vastly different amounts of actual funds in relation to their nominal size.[16] The resulting composite presentation would blend the results of these accounts into a rate of return that would not be representative of any client's actual results. Some might argue that if the actual funds-based returns of these varyingly funded accounts differed materially from each other, their performance should be presented in separate tables.[17] This could result in numerous performance tables for each of the CTA's programs, overwhelming clients with excessive amounts of data and severely impeding the usefulness of the performance disclosure.

The fully-funded subset method has turned out to be unworkable for a number of reasons. The primary reason is that many CTAs lack fully-funded accounts. Although Advisory 93–13 allows for limited periods during which the fully-funded subset requirement is not met, this allowance is predicated on the anticipated resumption of the fully-funded subset in the near future. The Division has received numerous questions over the years from CTAs who have qualified for the fully-funded subset method for a period of time, but due to the closing of fully-funded accounts and inability to obtain new fully-funded accounts, cannot continue to use the fully-funded subset method.

Further, in recent years, the use of ''master accounts'' by commodity pools and clients who allocate to multiple CTAs has greatly increased. A master account is a central account in which a client deposits funds with the FCM to support trading done by several CTAs. Each of the CTAs is given trading authority for a sub-account, which will reflect the positions implemented by that CTA, and profits and losses on these positions, but to which no funds will be deposited. The margin requirements for these positions will be met by funds maintained in the master account. Although the CTA will know the nominal account size, the actual funds reported to the CTA will include only the value of the positions held in the sub-account (which could, in fact, be a negative amount due to unrealized losses). While in the past staff have permitted the allocation of funds in a master account to various CTAs to be computed and reported pursuant to a Liquid Asset Allocation (''LAA'') method,[18] LAA methods have not proven to be workable for the majority of CPOs and other clients with master accounts. Further, it is unclear that such

[12] ''Fully-funded'' refers to an account where the amount of Actual Funds equals the nominal account size.

[13] Advisory 93–13 included a specific definition of ''materially the same'' in the context of comparing two percentages, depending on the individual size of the two percentages (*i.e.*, 5 percent or less, between 5 percent and 10 percent, or 10 percent or more) and the difference between the two percentages. See 58 FR at 8229.

[14] Additional changes to Rule 4.35(a)(6)(i)(A)–(F) have been proposed to accommodate the use of nominal account size. These changes will be discussed further below.

[15] For example, Client A and Client B each have a nominal account size of $100,000. The CTA treats the two accounts identically, trading two S&P 500 futures contracts for each account. Each account experiences a $10,000 profit. Client A deposits $25,000 in actual funds, while Client B fully funds the account with $100,000. Using the actual funds method, Client A's rate of return would be 40%, and Client B's rate of return would be 10%, even though each client has the same nominal account size, has been traded identically, and has received the same dollar amount in profits.

[16] In practice, prior to the issuance of Advisory 93–13, Division of Trading and Markets staff interpreted the actual funds method to require one composite table that was based solely on actual funds, and to permit a supplemental table including ''notional funds'' (57 FR 53457, 53459 (November 10, 1992). This interpretation appears to have been based on provisions regarding retroactive application of Advisory 87–2, as described in an Addendum to CFTC Advisory 87–2 ([1986–87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,759 (August 12, 1987)).

[17] Rule 4.35(a)(3)(ii) specifies that accounts whose rates of return differ materially from each other may not be presented in the same composite.

[18] See CFTC Interpretative Letter 88–1, ''Application of Division of Trading and Markets Advisory 87–2,'' [1987–1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24058 at 34639–40 (December 16, 1987).

allocation provides insight into the return based on ''actual'' funds.

3. Objections to the Nominal Account Size Method Addressed

Concerns have been raised that CTAs might manipulate their nominal account sizes.[19] A CTA that can establish nominal account sizes without being required to find customers willing to fully fund accounts at such sizes might be unrestrained in setting the nominal account size, and thus could minimize the apparent size of losses and smooth the apparent volatility of its trading over time. Increasing the nominal account size to minimize the apparent size of losses, however, will unavoidably have the effect of minimizing the apparent size of gains. CTAs will thus be faced with countervailing incentives. Some have noted a converse problem posed by the existing rules: futures and derivatives positions can be taken by depositing very small amounts of actual funds for margin, relative to the value of the contract. Positive rates of return computed on the basis of a relatively small amount of actual funds in accounts whose level of trading is based on a much greater nominal account size would be magnified and could provide a potentially misleading measure of the CTA's success. As NFA's comment letter on the earlier rule amendment proposal observed, in its experience, ''* * * unwary customers are more likely to be lured into the futures markets by allusions to large profits than by information implying that futures trading is a conservative investment.'' The Commission's own experience in this area has been similar, and it has no basis to believe that this proposal creates any additional incentives for CTAs to set unreasonable nominal account sizes.

Some have stated that using nominal account size to compute rates of return would create an appearance of lowered volatility and that disclosure of volatility experienced by program participants would be undermined if nominal account size were used to compute rates of return. But the rules proposed in this release are no more likely to mask volatility than the fully-funded subset method permitted since 1993. The funding level—full or partial—chosen by past participants neither helps nor harms prospective participants who will be receiving past performance data based on nominal account size. A prospective participant who chooses to partially fund will experience volatility magnified by his or her partial funding level, and will not be helped by the fact that other participants chose to fully fund in the past. Conversely, a prospective participant who chooses to fully fund will experience volatility corresponding to the nominal account size, and will not be harmed by the fact that other participants chose to partially fund in the past. Moreover, the performance table will contain a pointed numerical example of the effect of partial funding on volatility in the context of worst monthly and peak-to-valley draw-downs. This example–based either on the lowest actual funding level or a straight 20% funding level—will demonstrate the enhanced volatility of partially funded accounts in a form calculated to draw the participant's attention.

Investors should consider not only the ''cash they must put up'' initially, but the losses to which they are exposed. In this context, participation in managed futures accounts is far different from investment in stocks, real estate, or even commodity pools. As has been noted: ''Commodity trading intrinsically involves leverage, the only purchase is a futures contract (not the actual asset) and the amount of cash required is artificially determined by exchange rules, broker policies, CTA negotiated agreements and regulatory requirements and can change day by day.''[20]

Investments in stock, real estate, or collective investment vehicles such as mutual funds or commodity pools can be quantified in advance, even if purchased on margin or through other borrowing. An investor can purchase 100 shares of Example Co., Inc. (or Example Fund, Inc.) at $50 a share for $5,000. Even if these shares are purchased on margin, $5,000 is generally the limit of the loss to which the investor is exposed.[21] This relative certainty is absent in the context of futures. A managed futures account participant who enters into, for example, a stock index futures contract gains (or loses) the change in value of the collection of stocks. The participant must post margin, but the margin does not represent the limit of the participant's liability. If the participant's losses exceed the initial margin, the participant will owe the excess. Commission Rule 4.34(b) requires that CTAs disclose these facts to prospective clients, and a CTA which encouraged participants to think of the ''cash they have put up'' as the limit of their losses could run afoul of Section 4*o* of the Commodity Exchange Act (the ''Act'').[22]

To be sure, the Commission has observed that there is no standard among CTAs for the setting of nominal account sizes.[23] The Commission does not intend to impose a standard for the setting of nominal account sizes on CTAs. The proposed rule does require that the CTA disclose the factors it considers in determining the level of trading for a given nominal account size in the offered trading program and an explanation of how those factors are applied. Moreover, adopting nominal account size as the denominator for the rate of return calculation would provide a uniform basis for all CTAs to present rate of return, which does not exist under the reporting scheme that has been in effect since the adoption of Advisory 93–13. Use of nominal account size would permit a much more meaningful comparison of the performance results of CTAs.

After consideration of the benefits and drawbacks of each of these methods of calculating CTAs' rates of return, the Commission is proposing the nominal account size method, coupled with a framework of documentation and disclosure requirements, as the method that best reflects the reality of how managed accounts are traded, including information regarding volatility and draw-downs. As discussed more fully below, the existence of a written agreement that documents the nominal account size in advance of the CTA's trading for the account is a critical component of the performance calculation and reporting scheme the Commission is proposing.

B. Documentation of Nominal Account Size

The proposed rules would add new paragraph (c) to Rule 4.33 to require documentation of the nominal account size agreed upon by the CTA and client, as well as other terms applicable to the CTA's trading for the client's account. This provision would require that the CTA execute a written agreement with each client that specifies: The nominal account size; the name or description of the trading program in which the client is participating; the basis for the computation of fees; how additions or withdrawals of actual funds, or profits and losses will affect each of (a) the nominal account size and (b) the computation of fees; and whether the client will fully or partially fund the

[19] See, *e.g.*, ''Proposed Rule Could Help Mask Commodity Trading Volatility,'' New York Times, September 2, 1999; and ''Commodity-Adviser Reporting Rule May Change,'' Wall Street Journal, September 7, 1999.

[20] Arthur F. Bell, Jr. & Associates commenting on the earlier rule amendment proposal.

[21] Transaction fees and interest are being ignored for the purposes of these examples.

[22] 7 U.S.C. 6*o* (2000).

[23] See 63 FR 33297 (June 18, 1998).

account. The requirement that the nominal account size must be documented in advance of the CTA's trading for the client's account will also minimize the possibility that CTAs will manipulate their returns to appear either less volatile or more positive by frequent adjustment of their nominal account sizes, particularly since any revision to the nominal account size must be documented in a new agreement, or an addendum to the existing agreement, signed by the client.

The Commission believes that documentation of the agreement between CTAs and their clients is important, even if all the CTA's client accounts are fully-funded, and therefore the proposed requirements of Rule 4.33(c) would apply to CTAs whether or not they accept partially funded accounts. As the proposed rule indicates, CTAs would not need to use a separate agreement to respond to the requirements specified in Rule 4.33(c), but could incorporate the requirements into their existing client agreements.

In addition, Rule 4.33(c) would require that changes to nominal account size, other than those explicitly provided for in the existing agreement (*e.g.*, the effect of gains/losses), must be in writing, must be signed by the client, and must explicitly indicate the current date, the change in the nominal account size and the effective date of that change.[24] This requirement could be met by a simple one-sentence note from the client requesting the change in nominal account size and including the dollar amount of the new nominal account size, the effective date of the change, the signature and typed or printed name of the client, and the date the request was signed.[25]

C. Changes to Definitions

The Commission proposed revisions to Rule 4.10(l) to accommodate use of nominal account size as the denominator in the calculation of the peak-to-valley draw-down figures.[26]

[24] The effective date would be on or after the date that the change is made.

[25] Commission Rule 1.4 permits use of electronic signatures with respect to compliance with Commission rules that require a document to be signed by a customer, participant or client. An electronic signature could therefore be used for the agreement required by Rule 4.33(c), in accordance with the provisions of Rule 1.4 (*i.e.*, that the electronic signature complies with applicable Federal laws and other Commission rules, and that the CTA must adopt and utilize reasonable safeguards regarding the use of electronic signatures).

[26] Rule 4.10(k) defines ''draw-down'' as ''losses experienced by a pool or account over a specified period.'' Since the definition in Rule 4.10(k) does not refer to a method for computing such losses, no revision to this definition would be necessary.

Additional changes are being proposed to codify definitions of nominal account size (Rule 4.10(m)), actual funds (Rule 4.10(n)), partially-funded account (Rule 4.10(o)) and most recent five years (4.10(p)).

The Commission wishes to make clear that Advisories 87–2 and 93–13, as well as Interpretative Letter 88–1, would be, on a prospective basis, superseded in their entirety by the proposed rules or any final rules resulting from this rulemaking. Questions have been raised about the continuing applicability of the quantitative materiality standard that was established in Advisory 93–13 to determine whether a CTA's accounts qualified for use of the fully-funded subset method. Although Advisory 93–13 clearly stated that the standard was intended to be applicable only in the context of the Advisory, the Commission understands that these standards have come to be relied on more broadly in ascertaining compliance with composite performance requirements of Rule 4.35(a)(3). The Commission would accept those standards as guidance, but not to the exclusion of other approaches that may fall outside the threshold of Advisory 93–13. Registrants should continue to consider all relevant facts and circumstances in making determinations regarding materiality.

D. Disclosure of Actual Funding Levels and Funds Under Management

The Commission believes that it would be misleading to describe ''notional funds,'' which the client has chosen not to place in an account over which the CTA has trading authority, as ''funds under management.'' The proposed revisions to Rule 4.35(a)(1)(iv), therefore, would clarify that the disclosure of funds under management must reflect only the actual funds committed to the CTA's trading program rather than the aggregate of nominal account sizes.

The Commission's proposed adoption of nominal account size for purposes of computing the CTA's trading program rate of return is not intended to eliminate the distinction between actual funds and nominal account size. As we have noted before, nominal account size is not a commitment of actual funds to the CTA's control, nor does it represent the maximum amount of the client's potential losses or of the client's obligations to the FCM. The Commission continues to believe that knowledge of the amount of funds that a CTA's clients have been willing to entrust to the control of the CTA, or the fact that the CTA does not possess such information, may be considered valuable by prospective clients. In addition, CTAs would not be precluded from disclosing the aggregate of nominal account sizes, and in fact may choose to present such information in their performance capsules adjacent to the disclosure of actual funds under management (See proposed Rule 4.35(a)(1)(ix)(D)). Therefore, the Commission is proposing revisions to Rule 4.35(a)(1)(iv).

To accommodate those situations where CTAs do not have access to information regarding clients' actual funds, proposed Rule 4.35(a)(1)(iv) would permit a CTA simply to make a statement of the fact that it does not have sufficient information regarding the funding of its clients' accounts to determine the aggregate of actual funds committed to its programs. Cases involving the use of master accounts, or other funding arrangements between the client and FCM, that preclude the CTA from having access to information regarding the client's actual funds, might lead CTAs to state that they do not know the amount of actual funds. The representation by the CTA of its lack of knowledge of this amount will provide clients with valuable information regarding the extent to which they may rely on that factor. The CTA would continue to be required to maintain the documentation on which its performance presentation is based[27] and such documentation should be sufficient to support the information in the performance capsule regarding the disclosure, if any, of actual funds under management.

E. Disclosures Regarding Partial Funding of Accounts

Proposed Rule 4.34(p) would require disclosure to prospective clients of material information concerning the practice of partially funding an account and the factors considered by the CTA in determining the trading level for a given nominal account size. The discussion would be required to include: (1) How the management fees would be computed, expressed as a percentage of the nominal account size, and an explanation of the effect of partially funding an account on the management fees as a percentage of actual funds; (2) an estimated range of the commissions generally charged to an account expressed as a percentage of the nominal account size and an explanation of the effect of partially funding an account on the commissions as a percentage of actual funds; (3) a statement that partial funding increases leverage, that leverage will magnify both

[27] See Rules 4.33(a) and 4.35(a)(6)(ii).

positive and negative rates of return, and that the greater the disparity between the nominal account size and the amount deposited, maintained or made accessible to the FCM, the greater the likelihood and frequency of margin calls, and the greater the size of margin calls as a percentage of the amount of actual funds committed to the commodity trading advisor's program; and (4) a description of the factors considered by the CTA in determining the level of trading for a given nominal account size in the offered trading program and an explanation of how those factors are applied.

F. Disclosures Concerning Draw-down

1. Disclosure of Draw-Down at the Lowest Funding Level

Proposed Rule 4.35(a)(1)(ix)(A) would require CTAs who accept partially-funded accounts to present draw-down figures computed on the basis of the actual funds committed to the CTA's program by the client with the lowest ratio of actual funds to nominal account size in the trading program.[28] If the CTA did not have sufficient information regarding the funding level of its client accounts, or if the lowest ratio was zero, the draw-down information would be presented at a funding level of 20 percent. These additional draw-down figures would be presented adjacent to the worst monthly and peak-to-valley draw-down percentages based on the aggregate nominal account sizes.

If a client funds its account traded by the CTA at a level of actual funds that is less than the nominal account size, then gains or losses will represent a larger percentage of the client's actual funds. Further, the smaller the amount of actual funds is in relation to the nominal account size, the faster losses will reduce the amount of actual funds, increasing both the likelihood of margin calls and the amount of additional margin that may be required. The purpose of disclosing draw-downs at the least-funded level is to highlight these effects to prospective clients who may be considering partially funding their accounts with the CTA. The option of using a 20% level is intended to accommodate situations where the CTA does not have sufficient information regarding the funding level of its client accounts, or where the lowest funding ratio is zero, precluding calculation of a meaningful number.

Proposed Rule 4.35(a)(1)(ix)(A) would require the addition of only two percentage draw-down figures, adjacent to the worst monthly and peak-to-valley draw-down percentages for the aggregate nominal account sizes. This would not amount to data overload. Further, since the intent of the disclosure is to convey the impact of draw-downs on the actual funds in partially-funded accounts, use of the 20% funding level where CTAs do not have any accounts with actual funding or do not know the amount of actual funds would enable their performance capsules to convey information about the increased impact of draw-downs on the actual funds in partially-funded accounts.

2. Use of Composite Draw-down

Proposed Rules 4.35(a)(1)(v) and (vi) would require that the worst monthly and peak-to-valley draw-down amounts be based on the aggregate of nominal account sizes, *i.e.*, the composite of accounts, rather than the worst individual account.[29] A variety of factors, including, but not limited to, differences due to trade execution, fees, commissions, and the timing of opening or closing accounts, may have an impact on the returns for individual accounts. The effect of these factors must be considered by the CTA in the development of its composite performance tables and any material differences among the accounts in the composite must be discussed.[30] For a performance table that complies with the Commission's rules on use of composites, disclosure of draw-down information on a composite basis would not be misleading. However, CTAs would remain subject to the requirement of Rule 4.34(o) to disclose all material information to existing or prospective clients even if such information is not specifically required by these regulations.

G. Treatment of Interest Income

The proposed definition of net performance in Rules 4.10(*l*)(3) and 4.35(a)(6)(i)(B)[31] would permit CTAs to include interest income on funds deposited in the client's commodity interest account directed by the CTA, as well as any other income on positions held as part of the CTA's program. The fact that trading fees are charged against the CTA's performance, even where the commission rate is negotiated by the client and the FCM, supports the inclusion of interest earned at the FCM in the CTA's performance to maintain parity. In addition, interest is, in a real sense, part of the return on the funds. Regardless of the amount of actual funds a client deposits with the FCM, whether influenced by the CTA's trading strategies, the FCM's credit determination, or the client's wishes, income on these funds is part of the account's performance. Further, the computation of net performance under the regulations that have been in effect since 1981 has included interest income. The components of net performance—the numerator of the rate of return computation—will not be affected by the change of the denominator from net asset value to nominal account size. It is the adoption of nominal account size, rather than net asset value, as the basis for performance calculation that will require changes to the definition of net performance in proposed Rules 4.10(l)(3) and 4.35(a)(6)(i)(B).

The proposed rule also would provide that no interest income may be imputed with respect to nominal account sizes or otherwise computed on a pro-forma basis. The Commission notes that the reference in the proposed rules to ''other income'' on instruments held as part of the CTA's program is intended to apply to programs in which the CTA may direct the trading of instruments, such as stocks or bonds, on which income is earned.[32] While this provision may not be applicable to most CTAs, it is intended to permit those CTAs who direct the trading of income-producing

[28] For example, if the lowest funding level is 25 percent and the greatest monthly draw-down is 15 percent, the draw-down shown on the basis of actual funding would be 60 percent (15 percent ÷ 25 percent).

[29] Current Rule 4.10(k) defines the term ''Draw-down as ''losses experienced by a pool or account over a specified period: Rule 4.10(l) defines the term ''Worst peak-to-valley draw-down'' for a pool, account or trading program. In its adopting release for the most recent revisions to the Part 4 rules, the Commission noted that '' . . . the draw-down figures in a composite in a CTA Disclosure Documents are the worst experienced by *any one of the accounts* included in the composite'' (emphasis added). 60 FR 38146, 38162 (July 25, 1995).

[30] Rule 4.35(a)(3) states:

(i) Unless such presentation would be misleading, the performance of accounts traded pursuant to the same trading program may be presented in composite form on a program-by-program basis * * *.

(ii) Accounts that differ materially with respect to rate of return may not be presented in the same composite.

(iii) The commodity trading advisor must discuss all material differences among the accounts included in a composite.

[31] Although net performance is defined in the context of both Rule 4.10(*l*), with respect to computation of worst peak-to-valley draw-down, and Rule 4.35(a)(6)(i)(B), with respect to calculation of performance information, the definitions are the same.

[32] While this provision acknowledges that CTAs may offer programs that trade instruments in addition to futures contracts, it in no way implies that such activity may be conducted by CTAs outside of the appropriate registration or other regulatory requirements of agencies with jurisdiction over those instruments.

instruments as part of their trading programs to reflect the performance of those instruments in their trading results. In the disclosure document review process and compliance audits, close attention would be paid to the description of the trading program and other documentation regarding the CTA's direction of income-producing instruments included in its performance record.

H. Range of Rates of Return for Closed Accounts

The Commission proposes to revise Rule 4.35(a)(1)(viii) to require that the performance capsule for the offered program include, in addition to the number of accounts closed with profits and the number closed with losses, the range of rates of return for the accounts closed with net lifetime profits and accounts closed with net lifetime losses, during the five-year period. The Commission believes that disclosing the range of rates of return for closed accounts in the offered program provides important summary information on the variation in returns experienced by individual clients and will be useful to prospective clients considering participation in the CTA's program. Because the draw-down information under the revised rules will be presented on a composite basis, presentation of the range of rates of return for closed accounts provides valuable information on the results experienced by individual clients.

The Commission notes that under the proposed rule amendments, both the numbers of accounts closed with positive versus negative rates of return, as well as the ranges of rates of return for accounts in each category, must be disclosed only for those accounts that both opened and closed within the required five-year and year-to-date time period. The Commission does not believe that this change will diminish the disclosure of material information to prospective clients, because of the tendency of clients to quickly close accounts that experience large losses. Accounts that experienced strongly negative returns before the five-year time period are likely to have been closed before the end of that time period, and losses experienced as a result of the offered program during the five-year period are likely to have been experienced by an account that both opened and closed during that period. The Commission wishes to make clear that any additional information that the CTA believes is necessary to explain the circumstances affecting the ranges of returns presented in the performance capsule may be provided, pursuant to existing rules regarding supplemental disclosures and material information.[33]

I. Treatment of Additions and Withdrawals in Computing Rate of Return

In proposing to amend Rule 4.35(a)(6)(i)(B), the Commission notes that CTAs would be permitted to choose, for their rate of return computation, one of the following three methods: (1) Net performance divided by beginning nominal account size; (2) daily compounded rate of return; or (3) net performance divided by the average weighted nominal account sizes for the month. These proposed changes would incorporate alternative methods of computing rate of return to account for intramonth additions and withdrawals, as permitted by the CFTC's 1991 Advisory.[34] The Commission is not proposing to include the Only Accounts Traded Method as an option CTAs may choose prospectively due to concerns that it allows for accounts to be excluded entirely from the rate of return computation. The Commission will, however, carefully consider proposals regarding any alternative method of addressing the effect of additions and withdrawals on the rate of return computation, whether as part of this rulemaking proposal or otherwise in the future.

The rule changes proposed herein would supersede applicability to CTAs of the CFTC's 1991 Advisory.[35] CTA performance computed in accordance with any of the alternative methods described in the 1991 Advisory for periods prior to the date upon which the rule changes proposed herein become effective, however, would not need to be revised. Because commodity pool performance may only be reported on the basis of actual funds, applicability of the 1991 Advisory to CPOs reporting commodity pool performance would be unchanged.

J. Disclosure of CTA Performance in CPO Disclosure Documents

The Commission is proposing changes to the presentation of CTA performance in CPO disclosure documents primarily to conform such presentation with the proposed revisions to Rule 4.35(a)(1). The Commission emphasizes that narrative disclosure of the pool's allocations to its CTAs, as well as the use of leverage in determining such allocations, continues to be required pursuant to existing Rules 4.24(g) and 4.24(h).

III. Transitional Provisions

The Commission proposes to require CTAs and CPOs to comply with the revisions proposed herein, including the requirement to obtain the documentation required by new Rule 4.33(c) for both new and existing clients, by no later than the beginning of the calendar quarter that is at least 90 days after the date of publication of the final rules. The Commission seeks comment on any difficulties anticipated in complying with these proposed requirements by that date. CTAs and CPOs would be permitted to adopt these changes immediately upon the effective date of the final rules as adopted.

IV. Request for Comments Regarding a Core Principle Alternative

The Commission has received a number of requests from the managed funds industry that Commission policy pertaining to CTA disclosure of past performance to prospective clients be made consistent with the approach undertaken in the securities industry.[36] Under Federal securities laws there are no rules that mandate the manner in which investment advisers disclose past performance. Generally, investment advisers may present past performance in any manner that does not run afoul of general anti-fraud provisions.[37] It has been suggested that the Commission adopt a core principle in order to achieve parity with applicable securities laws and regulations as they relate to the disclosure of past performance made by CTAs to prospective clients.[38] Such a core principle would permit CTAs to present past performance to prospective clients in any manner they choose so long as such information is offered in a manner that is factual and balanced and is not misleading or fraudulent.

Consistent with the intention of the Commodity Futures Modernization Act

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[33] *See,* Commission Rules 4.34(n) and 4.34(o).

[34] CFTC Advisory, "Adjustments for Additions and Withdrawals to Computation of Rate of Return in Performance Records of Commodity Pool Operators and Commodity Trading Advisors," 56 FR 8109 (February 27, 1991).

[35] CFTC Advisory, "Adjustments for Additions and Withdrawals to Computation of Rate of Return in Performance Records of Commodity Pool Operators and Commodity Trading Advisors," 56 FR 8109 (February 27, 1991).

[36] *See* Transcript from CFTC Roundtable on Managed Funds Issues <*http://www.cftc.gov/files/opa/press02/oparoundtable091902.pdf*>.

[37] *See* the Investment Advisers Act of 1940 section 206(4) (15 U.S.C. 80b–6(4)) and Securities and Exchange Commission Rule 275.206(4)–1(a)(5) (17 CFR 275.206(4)–(1)(a)(5)). For a more complete discussion regarding the use of past performance by investment advisers for soliciting clients, *see* Robert J. Zutz, *Compliance Review,* Schwab Institutional, Vol. 10, Issue 8, Aug. 2001.

[38] *See,* e.g., Testimony of George Crapple at the CFTC Roundtable on Managed Funds Issues. Transcript from CFTC Roundtable on Managed Funds Issues at 84.

of 2000,[39] the Commission is requesting comment on the desirability of implementing a core principle that would replace the current rules, and ameliorate the need for the amendments proposed herein, regarding the manner in which a CTA presents past performance to prospective clients. In particular, the Commission is requesting comments on the following questions:

(1) What form should such core principle take? Commenters are requested to provide specific language for the core principle.

(2) Should certain presentations of past performance be specifically prohibited or limited?

(3) Should the rules proposed herein serve as a safe harbor in the event the Commission determines to adopt a core principle approach, and/or should the Commission develop more general guidance concerning compliance with the core principle?

(4) Would the implementation of a core principle approach lead to more or less meaningful and useful information being provided to prospective clients?

(5) Is the experience of the securities industry with the use of a core principle approach for performance presentation relevant to the use of such an approach in the futures industry?

In offering the above questions, the Commission does not intend to limit the scope of the discussion regarding the alternative of a core principle. These questions are meant only as a starting point and the Commission encourages the submission of comments that address these, as well as any other pertinent questions.

V. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (''RFA''), 5 U.S.C. 601–611 (1994), requires that agencies, in proposing rules, consider the impact of those rules on small businesses. The Commission has previously established certain definitions of ''small entities'' to be used by the Commission in evaluating the impact of its rules on such entities in accordance with the RFA.[40] The Commission previously has determined that registered CPOs are not small entities for the purpose of the RFA.[41] With respect to CTAs, the Commission has stated that it would evaluate within the context of a particular rule proposal whether all or some affected CTAs would be considered to be small entities and, if so, the economic impact on them of any rule.[42] In this regard, the Commission notes that the rule revisions adopted herein create some changes to the content of the documentation and disclosure requirements for CTAs, but do not increase such requirements, and, in fact, are expected ultimately to ease the computational and recordkeeping requirements for CTAs who manage partially-funded client accounts. The Commission has previously determined that the disclosure requirements governing this category of registrant will not have a significant economic impact on a substantial number of small entities.[43] Therefore, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that these regulations will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

These rules [Sections 4.31 and 4.33] contain information collection requirements. As required by the Paperwork Reduction Act of 1995,[44] the Commission has submitted a copy of this rule to the Office of Management and Budget (OMB) for its review.[45]

Collection of Information

Rules relating to the operations and activities of Commodity Pool Operators and Commodity Trading Advisors and to monthly reporting by Futures Commission Merchants, OMB control number 3038–0005.

The proposed amendments would not affect the paperwork burdens associated with the above collections of information, which have previously been approved by OMB in connection with the Commission's previous submission of the proposed rules.

Copies of the information collection submission to OMB are available from the CFTC Clearance Officer, 1155 21st Street, NW., Washington, DC 20581, (202) 418–5160.

Persons wishing to comment on the information collection requirements that would be required by these proposed rules should contact the Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10235, New Executive Office Building, Washington, DC 20503, Attn: Desk Officer for the Commodity Futures Trading Commission.

The Commission considers comments by the public on this proposed collection of information in—

Evaluating whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have a practical use;

Evaluating the accuracy of the Commission's estimate of the burden of the proposed collection of information including the validity of the methodology and assumptions used;

Enhancing the quality, utility, and clarity of the information to be collected; and

Minimizing the burden of the collection of the information on those who are to respond, including through the use of appropriate automated, electronic, mechanical or other technological collection techniques or other forms of information technology, e.g., permitting electronic submissions of responses.

OMB is required to make a decision concerning the collection of information contained in these proposed regulations between 30 and 60 days after publication of this document in the **Federal Register**. Therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. This does not affect the deadline for the public to comment to the Commission on the proposed regulations.

Copies of the information collection submission to OMB are available from the CFTC Clearance Officer, 1155 21st Street, NW., Washington, DC 20581 (202) 418–5160.

List of Subjects in 17 CFR Part 4

Brokers, Commodity futures, Commodity pool operators, Commodity trading advisors.

In consideration of the foregoing and pursuant to the authority contained in the Commodity Exchange Act and, in particular, sections 1a(4), 4k, 4*l*, 4m, 4n, 4*o* and 8a, 7 U.S.C. 1a(4), 6k, 6*l*, 6m, 6n, 6*o*, and 12a, the Commission hereby proposes to amend Chapter I of the Code of Federal Regulations as follows:

PART 4—COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

1. The authority citation for part 4 continues to read as follows:

Authority : 7 U.S.C. 1a, 2, 4, 6b, 6c, 6l, 6m, 6n, 6o, 12a and 23.

2. Section 4.10 is proposed to be amended by revising paragraph (l) and adding paragraphs (m), (n), (o) and (p) to read as follows:

§ 4.10 Definitions.

* * * * *

[39] Pub. L. No. 106–554, 114 Stat. 2763 (2000) (codified as amended in scattered sections of 7 U.S.C.). *See, e.g.*, section 125 (requiring the Commission to conduct a study of the Act and the Commission's rules and orders governing the conduct of registrants under the Act, identifying, among other things, Commission rules that may be replaced by core principles).

[40] 47 FR 18618–18621 (April 30, 1982).

[41] 47 FR 18619–18620.

[42] 47 FR 18618–18620.

[43] See 60 FR 38146, 38181 (July 25, 1995) and 48 FR 35248 (August 3, 1983).

[44] Pub. L. 104–13 (May 13, 1995).

[45] 44 U.S.C. 3504(h).

(l) *Worst peak-to-valley draw-down* means:

(1) For a commodity pool, the greatest cumulative percentage decline in month-end net asset value due to losses sustained during any period in which the initial month-end net asset value is not equaled or exceeded by a subsequent month-end net asset value. Such decline must be expressed as a percentage of the initial month-end net asset value, together with an indication of the months and year(s) of such decline from the initial month-end net asset value to the lowest month-end net asset value of such decline.

(2) For an account directed by a commodity trading advisor or for a commodity trading advisor's trading program, the greatest negative net performance during any period, beginning at the start of one month, and ending at the conclusion of that month or a subsequent month. The worst peak-to-valley draw-down must be expressed as a percentage of the nominal account size at the beginning of the period, together with an indication of the months and year(s) of such draw-down.

(3)(i) For purposes of paragraph (l)(2) of this section, net performance for a period is defined as the total of:

(A) The realized gain or loss on positions closed during the period; plus

(B) The change during the period in unrealized gain or loss; plus

(C) Interest income on funds on deposit in an account at a futures commission merchant to margin the client account which a commodity trading advisor directs; plus

(D) Other income earned on positions held as part of the commodity trading advisor's program; minus

(E) Fees and expenses.

(ii) No interest or other income may be imputed with respect to nominal account sizes or otherwise computed on a pro-forma basis.

(4) For purposes of §§ 4.25 and 4.35, a peak-to-valley draw-down, which began prior to the beginning of the most recent five calendar years and continues into or ends during the most recent five years, is deemed to have occurred during such five-calendar-year period.

(m) *Nominal account size* means the account size, designated in the written agreement specified in § 4.33(c), that establishes the client's level of trading in a commodity trading advisor's program.

(n) *Actual funds* means the amount of margin-qualifying assets, either:

(1) On deposit in an account at a futures commission merchant to margin the client account which a commodity trading advisor directs; or

(2) In another account, so long as the commodity trading advisor has written evidence demonstrating the following:

(i) The client owns the funds;

(ii) The futures commission merchant carrying the client's account that the commodity trading advisor directs (the ''trading account'') has the power readily to use all, or a designated portion of, the funds in the other account for the purpose of meeting margin requirements in connection with the trading account, on a routine operational basis and without advance notice to the client; and

(iii) The commodity trading advisor has ready access to information concerning the balance in the other account available to meet margin requirements for the trading account.

(o) *Partially-funded account* means a client participation in the program of a commodity trading advisor in which the amount of actual funds is less than the nominal account size.

(p) For purposes of §§ 4.25 and 4.35, the term most recent five years means:

(1) The time period beginning January 1 of the calendar year five years prior to the date of the Disclosure Document and ending as of the date of the Disclosure Document; or

(2) The life of the trading program, if less than five years.

3. Section 4.25(a)(1)(ii) is proposed to be amended by revising paragraphs (a)(1)(ii)(D)(1) and (2), (a)(1)(ii)(E) and (a)(1)(ii)(F) to read as follows:

§ 4.25 Performance disclosures.

(a) * * *

(1) * * *

(ii) * * *

(D)(1) The aggregate of actual funds for all of the trading programs of the trading advisor or other person trading the account, as of the date of the Disclosure Document or, if the commodity trading advisor does not have sufficient information regarding the funding of its clients' accounts to determine the aggregate of actual funds for its programs, a statement of that fact;

(2) The aggregate of actual funds for the specified trading program of the commodity trading advisor, as of the date of the Disclosure Document or, if the commodity trading advisor does not have sufficient information regarding the funding of its clients' accounts to determine the aggregate of actual funds for the specified trading program, a statement of that fact.

(E) The greatest monthly draw-down during the most recent five years for the trading program specified, expressed as a percentage of aggregate nominal account sizes, and indicating the month and year of the draw-down.

(F) The greatest peak-to-valley draw-down during the most recent five years for the trading program specified, expressed as a percentage of aggregate nominal account sizes at the beginning of the period, and indicating the month(s) and year(s) of the draw-down.

* * * * *

4. Section 4.33 is proposed to be amended by adding paragraphs (c) and (d) to read as follows:

§ 4.33 Recordkeeping.

* * * * *

(c) A commodity trading advisor must obtain a written agreement signed by each client which, at a minimum, clearly specifies:

(1) The nominal account size;

(2) The name or description of the trading program in which the client is participating;

(3) The basis for the computation of fees;

(4) How additions or withdrawals of actual funds, profits, and losses will each affect the nominal account size and the computation of fees; and

(5) Whether the client will fully or partially fund the account.

(d) Any changes to nominal account size (other than changes resulting from the factors listed in § 4.33(c)(4) and documented as required by that subsection) must be in writing, must be signed by the client, and must explicitly indicate the current date, the new nominal account size and the effective date of the change.

5. Section 4.34 is proposed to be amended by adding paragraph (p) to read as follows:

§ 4.34 General disclosures required.

* * * * *

(p) Additional Disclosure by Commodity Trading Advisors Accepting Partially-funded Accounts. A commodity trading advisor that accepts a partially-funded account (as defined in § 4.10(o)) must disclose:

(1) How the management fees will be computed, expressed as a percentage of the nominal account size, and an explanation of the effect of partially funding an account on the management fees as a percentage of actual funds;

(2) An estimated range of the commissions generally charged to an account expressed as a percentage of the nominal account size and an explanation of the effect of partially funding an account on the commissions as a percentage of actual funds;

(3) A statement that partial funding increases leverage, that leverage will magnify both positive and negative rates of return, and that the greater the disparity between the nominal account

size and the amount deposited, maintained or made accessible to the futures commission merchant, the greater the likelihood and frequency of margin calls, and the greater the size of margin calls as a percentage of the amount of actual funds committed to the commodity trading advisor's program; and

(4) A description of the factors considered by the commodity trading advisor in determining the level of trading for a given nominal account size in the offered trading program and an explanation of how those factors are applied.

6. Section 4.35 is proposed to be amended by revising paragraphs (a)(1)(iv) through (a)(1)(ix), (a)(2)(iv), (a)(6)(i)(A) through (F), and (a)(6)(ii) to read as follows:

§ 4.35 Performance disclosures.

* * * * *

(a) General principles.—(1) * * *

(iv)(A) The aggregate of actual funds for all of the trading programs of the trading advisor or other person trading the account, as of the date of the Disclosure Document, or, if the commodity trading advisor does not have sufficient information regarding the funding of its clients' accounts to determine the aggregate of actual funds for its programs, a statement of that fact;

(B) The aggregate of actual funds for the specified trading program of the commodity trading advisor, as of the date of the Disclosure Document, or, if the commodity trading advisor does not have sufficient information regarding the funding of its client accounts to determine the aggregate of actual funds for the specified trading program, a statement of that fact.

(v) The greatest monthly draw-down during the most recent five years for the trading program specified, expressed as a percentage of aggregate nominal account sizes, and indicating the month and year of the draw-down;

(vi) The greatest peak-to-valley draw-down during the most recent five years for the trading program specified, expressed as a percentage of aggregate nominal account sizes at the beginning of the period, and indicating the month(s) and year(s) of the draw-down;

(vii) Subject to § 4.35(a)(2) for the offered trading program, the annual and year-to-date rate-of-return for the program specified for each of the five most recent calendar years and year-to-date, computed on a compounded monthly basis; and

(viii) In the case of the offered trading program:

(A)(1) The number of accounts traded pursuant to the offered trading program that were opened and closed during the period specified in § 4.35(a)(5) with a positive net lifetime rate of return as of the date the account was closed; and

(2) The range of rates of return for accounts that were both opened and closed during the period specified in § 4.35(a)(5) and closed with positive net lifetime rates of return; and

(B)(1) The number of accounts traded pursuant to the offered trading program that were opened and closed during the period specified in § 4.35(a)(5) with negative net lifetime rates of return as of the date the account was closed; and

(2) The range of rates of return for accounts that were both opened and closed during the period specified in § 4.35(a)(5) and closed with negative net lifetime rates of return.

(C) The net lifetime rate of return shall be calculated as the compounded product of the monthly rates of return for each month the account is open.

(ix) In addition to the information specified in § 4.35(a)(1)(i)–(viii), where the commodity trading advisor accepts partially-funded accounts, the performance capsule must include:

(A) A statement that rates of return are based on nominal account size.

(B) In a column adjacent to the presentation of data based on nominal account size, the draw-down information required by § 4.35(a)(1)(v) and (vi), divided by the percentage of actual funds committed to the commodity trading advisor's program by the client with the lowest ratio of actual funds to nominal account size in the trading program.

(1) If the commodity trading advisor does not have sufficient information regarding the funding level of its client accounts to determine the lowest ratio, or if the lowest ratio is zero, present this information at a funding level of 20 percent.

(2) The percentage basis of the computation, *i.e.*, the actual funds ratio or the optional 20 percent, must be disclosed in the heading of the column.

(C) If the commodity trading advisor elects to include the aggregate of the nominal account sizes of the client accounts in the trading program specified, this information must be placed adjacent to the disclosure of actual funds under management by the commodity trading advisor as required by § 4.35(a)(1)(iv).

(2) Additional requirements with respect to the offered trading program.

* * * * *

(iv) The commodity trading advisor must make available to prospective and existing clients upon request a table showing the information required to be calculated pursuant to § 4.35(a)(6). This table must be updated at least quarterly.

* * * * *

(6) Calculation of, and recordkeeping concerning, performance information.

(i) * * *

(A) The nominal account size at the beginning of the period, defined as the previous period's ending nominal account size;

(B)(1) The net performance for the period, which is defined as the total of:

(i) The realized gain or loss on positions closed during the period, plus

(ii) The change during the period in unrealized gain or loss, plus

(iii) Interest income on funds on deposit in an account at a futures commission merchant to margin the client account which a commodity trading advisor directs, plus

(iv) Other income earned on positions held as part of the CTA's program, minus

(v) Fees and expenses.

(2) No interest or other income may be imputed with respect to nominal account sizes or otherwise computed on a pro-forma basis.

(C) The nominal rate of return for the period, which must be compounded no less frequently than monthly and which shall be calculated by one of the following three methods, consistently applied:

(1) Computing the net performance divided by the beginning nominal account size for each trading day in the period and compounding each daily rate of return to determine the rate of return for the period;

(2) Dividing the net performance by the arithmetic mean of the nominal account sizes for each trading day during the period; or,

(3) Dividing the net performance by the nominal account size at the beginning of the period.

(D) Changes to the nominal account size during the period, pursuant to the terms of the commodity trading advisor's agreement with the client in accordance with § 4.33(c)(4). The records should clearly delineate the source of each change (additions or withdrawals of actual funds, profits or losses, or otherwise).

(E) Changes to the nominal account size pursuant to the terms of the commodity trading advisor's agreement with the client in accordance with § 4.33(c)(1). The records should clearly delineate the source of each change (the opening or closing of accounts during the period or changes to nominal account size specifically directed by a client in writing). If a client and the advisor agree that a nominal account

size be changed effective at the beginning of a period, the change shall be reflected at the end of the prior period.

(F) The nominal account size at the end of the period, defined as the sum of the nominal account size at the beginning of the period [§ 4.35(a)(6)(i)(A)] and the changes specified in this § 4.35(a)(6)(i) subparagraphs (D) and (E).

(ii) All supporting documents necessary to substantiate the computation of such amounts must be maintained in accordance with § 1.31.

* * * * *

Issued in Washington, DC on March 10, 2003 by the Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 03–6081 Filed 3–12–03; 8:45 am]

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DEPARTMENT OF THE TREASURY

Customs Service

19 CFR PART 181

RIN 1515–AD23

Tariff Treatment Related to Disassembly Operations Under the North American Free Trade Agreement

AGENCY: Customs Service, Department of the Treasury.

ACTION: Proposed rule.

SUMMARY: This document proposes to amend the Customs Regulations concerning the North American Free Trade Agreement (the NAFTA). Specifically, the proposed rule would allow components which are recovered from the disassembly of used goods in a NAFTA country to be entitled to NAFTA originating status when imported into the United States, provided that: The recovered components satisfy the applicable NAFTA rule of origin requirements; and if the applicable rule of origin does not include a regional value content requirement, the components are subject to further processing in the NAFTA country beyond certain minor operations.

The proposed rule is intended to promote economic activity and the protection of the environment in North America, both of which are goals of the NAFTA. To this end, the recovery and recycling of used goods is a critical element in both the economic activity and the environmental goals of the nation, and disassembly for the recovery of used goods is a key process in many such recycling operations.

DATES: Comments must be received on or before May 12, 2003.

ADDRESSES: Written comments are to be addressed to the U.S. Customs Service, Office of Regulations and Rulings, Attention: Regulations Branch, 1300 Pennsylvania Avenue, NW., Washington, DC 20229. Submitted comments may be inspected at U.S. Customs Service, 799 9th Street, NW., Washington, DC during regular business hours. Arrangements to inspect submitted comments should be made in advance by calling Mr. Joseph Clark at (202) 572–8768.

FOR FURTHER INFORMATION CONTACT: Edward M. Leigh, Office of Regulations and Rulings, (202) 572–8827.

SUPPLEMENTARY INFORMATION:

Background

On December 17, 1992, the United States, Canada and Mexico (the parties) entered into an agreement, the North American Free Trade Agreement (the NAFTA). The provisions of the NAFTA were adopted by the United States with the enactment of the North American Free Trade Agreement Implementation Act, Public Law 103–182, 107 Stat. 2057 (December 8, 1993).

The question has arisen, in the context of recycling or re-manufacturing operations, whether disassembly occurring in a NAFTA country may be considered NAFTA origin conferring ''production'' where the components recovered by disassembly satisfy the Annex 401 rules of origin for the NAFTA and there is some form of substantial processing performed on the recovered components.

The NAFTA does not explicitly address whether parts or components, whose origin is non-NAFTA or unknown, that are recovered by disassembly in a NAFTA country from a non-originating good, may qualify as NAFTA originating goods if, as a result of the disassembly, they satisfy the rules of origin set out in Article 401 and Annex 401 of the NAFTA and are themselves subjected to some form of substantial further processing.

The recovery and recycling of used goods is an increasingly important element in the economic activity as well as the environmental goals of the nation, and disassembly, for the recovery of parts or for the re-manufacturing of a good, is a key process in many recycling operations.

The goals of the North American Free Trade Agreement (NAFTA) include elimination of barriers to trade, facilitation of cross-border movement of goods, promotion of economic activity in North America, and protection of the environment. The Department of the Treasury and Customs Service have examined NAFTA's rules of origin as applied to both recovered and recycled goods. Allowing disassembly to confer origin under certain circumstances promotes recycling and re-manufacturing in North America and would advance these economic and environmental objectives.

Proposed Rule

To this end, accordingly, this document proposes to amend the Customs Regulations to allow components which are recovered from the disassembly of used goods in a NAFTA country to be entitled to NAFTA originating status upon importation to the United States, provided that: (1) The recovered components satisfy the applicable NAFTA rule of origin requirements in Annex 401; and (2) if the rule of origin in Annex 401 applicable to the components does not include a regional value content requirement, the components are subject to further processing in the NAFTA country beyond certain specified minor operations.

Treatment of Disassembly as a Production Consistent with the Intent of NAFTA

Under the proposal, treatment of disassembly as potentially conferring NAFTA originating status must, of course, be consistent with the terms and objectives of the NAFTA Implementation Act of 1993. Within that framework, the most important question which must be answered is does ''disassembly'' constitute origin conferring ''production'' within the meaning of that term as defined in Article 415 of the NAFTA, as implemented in 19 U.S.C. 3332(a)(1)(B)(i) and 3332(p)(22) and in section 2(1) of the NAFTA Rules of Origin Regulations (Uniform Regulations) (19 CFR part 181, Appendix, section 2(1))?

A Change in Tariff Classification Resulting from a Production

Under NAFTA Article 401(b) and 19 U.S.C. 3332(a)(1)(B)(i), a good shall originate in the territory of a party where each of the non-originating materials used in the production of the good undergoes an applicable change in tariff classification set out in Annex 401 as a result of production occurring entirely in the territory of one or more of the parties. It is therefore understood that unless it results from an activity