CPO/CTA ALERT: CFTC ADOPTS AMENDMENTS TO ADVERTISING RULE

On February 23, 2007, the Commodity Futures Trading Commission adopted amendments to its advertising rule. Rule 4.41 governs the advertising activities of both registered *and unregistered* commodity pool operators and commodity trading advisors and their principals. The revised rule, which will be effective as of March 26, 2007, will (i) restrict the use of testimonials by CPOs and CTAs; (ii) change the prescribed text of the cautionary statement required to accompany simulated or hypothetical performance; and (iii) specifically include within the scope of Rule 4.41 advertisements that are disseminated electronically.

1. Use of Testimonials

New Rule 4.41(a)(3) will expressly prohibit CPOs and CTAs and their principals from using testimonials, unless the advertisement or sales literature providing the testimonial prominently discloses (i) that the testimonial may not be representative of the experience of other clients; (ii) that the testimonial is no guarantee of future performance or success; and (iii) if more than a nominal sum has been paid, the fact that it is a paid testimonial. The new provision was modeled on NASD Rule 2210(d)(2). Any testimonial that a CPO, a CTA or their principals include in advertising materials must be accompanied by the above-referenced disclaimers prescribed in amended Rule 4.41.

2. Hypothetical and Simulated Performance Disclaimer

Rule 4.41(b)(1) prohibits CPOs and CTAs and their principals from presenting any "simulated or hypothetical" performance unless such performance is accompanied by either (i) a cautionary statement that has been prescribed by a registered futures association (*i.e.*, the statement prescribed in National Futures Association Compliance Rule 2-29) or (ii) the cautionary statement prescribed in Rule 4.41(b)(1)(i). The statement in revised Rule 4.41(b)(1)(i) reads as follows:

> These results are based on simulated or hypothetical performance results that have certain inherent limitations. Unlike the results shown in an actual performance record, these results do not represent actual trading. Also, because these trades have not actually been executed, these results may have under- or over-compensated for the impact, if any, of certain market factors, such as lack of liquidity. Simulated or hypothetical trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. No representation is being made that any account will or is likely to achieve profits or losses similar to these being shown.

The CFTC specifically stated that this requirement applies to both registered *and unregistered* CPOs and CTAs, as well as to presentations to both qualified eligible persons ("QEPs") as defined in CFTC Rule 4.7 and non-QEPs. Further, the prescribed cautionary statement must be "prominently disclosed and in immediate proximity" to the performance being presented (CFTC Rule 4.41(b)(2)).

The CFTC declined to adopt a "bright-line" test for what constitutes "immediate proximity." The CFTC stated, however, that placing the statement on the cover page of a document would **not** be sufficient. CPOs and CTAs must use their "best judgment" to ensure that someone viewing performance results would understand that the cautionary statement is intended to refer to those particular results.

3. Electronic Distribution of Advertising Materials

Finally, the CFTC amended Rule 4.41(c)(1) expressly to include within its scope advertising materials that are distributed electronically (*e.g.*, via the internet or e-mail).

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