COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 4, 30, 150

Amendments to Commodity Pool Operator and Commodity Trading Advisor Disclosure Rules

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rules.

SUMMARY: The Commodity Futures Trading Commission (''Commission'') is announcing the adoption of substantial revisions to the disclosure framework applicable to commodity pool operators (''CPOs'') and commodity trading advisors (''CTAs''). These amendments are intended to achieve greater simplicity, focus and clarity in performance history; to streamline other required disclosures; to improve the presentation and understandability of disclosures to investors; and to create a more concise and readable format for Disclosure Documents.

EFFECTIVE DATE: August 24, 1995.

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SUPPLEMENTARY INFORMATION:

Table of Contents

I. Background

A. Development of Proposed Part 4 Revisions

On May 5, 1994, the Commission proposed comprehensive revisions to the disclosure framework for CPOs and CTAs (''Proposing Release'').[1] This proposal followed more than fifteen years of experience in administering the part 4 disclosure framework and reflected a comprehensive review of the disclosure requirements for CPOs and CTAs designed to identify aspects of the regulatory structure that could be streamlined or simplified, while enhancing appropriate customer protection. The first phase of this review resulted in the adoption of Rules 4.7 and 4.8 in 1992.[2] The adoption of the rules set forth herein is part of the second phase of the Commission's review of part 4.[3] As the Commission

[1] 59 FR 25351 (May 16, 1994). The initial sixty-day period for public comment on the Proposing Release expired on July 15, 1994 but was extended to August 17, 1994. The proposed amendments included conforming changes to other rules, *e.g.*, to Rule 30.6, which pertains to disclosures required of CPOs and CTAs offering pools or accounts, respectively, to trade in foreign futures contracts as defined in Rule 30.1. 59 FR 37189 (July 21, 1994).

The Commission's rules governing the operations of CPOs and CTAs are set forth in part 4 of the Commission's regulations, 17 CFR part 4 (1994). All other Commission rules referred to herein are found at 17 CFR Ch. I (1994).

[2] Rule 4.7 provides relief from certain disclosure, reporting and recordkeeping requirements applicable to CPOs for pools offered and sold only to ''qualified eligible participants'' and CTAs providing commodity interest trading advice to ''qualified eligible clients,'' as defined therein, and who satisfy other specified criteria for relief. Rule 4.8 provides relief from the twenty-one day Disclosure Document pre-filing requirement (now contained in new Rule 4.26(d)(1)) for CPOs of certain privately-offered pools.

[3] This second phase will also consider, in consultation with the Securities and Exchange

stated in the Proposing Release, the purposes of these revisions are: (1) Simplification of past performance disclosures; (2) reduction of required disclosures concerning matters of secondary relevance; and (3) clarification and modernization of various requirements.[4]

In announcing the adoption of part 4 in 1979, the Commission stated that the Disclosure Document requirement for CPOs was intended ''to protect pool participants—particularly those who are unsophisticated in financial matters—by ensuring that they are informed about the material facts regarding the pool before they commit their funds.'' [5] Similarly, the Disclosure Document requirement for CTAs was premised, in part, upon the view that ''a prospective (CTA) client or subscriber should be aware of the advisor's commodity and general business experience if he is to make an informed decision as to whether or not to avail himself of the advisor's services.'' [6]

In the Proposing Release, the Commission noted that since the original adoption of the part 4 rules, the number of registered CPOs had more than doubled and the number of CTAs had increased nearly threefold; [7] assets under the management of CPOs had grown dramatically; [8] and the range of available futures and option contracts had increased substantially.[9] In addition, during the past decade, trading structures and investment portfolios have become increasingly diverse and complex. A single commodity pool may engage multiple CTAs and invest in multiple commodity pools (''investee pools'') [10] or securities funds in order to access the services of particular traders or advisors, employ multiple trading strategies or programs, or diversify its portfolio.[11] Further, commodity pools frequently retain ''trading managers'' to recommend or select CTAs to manage, or funds in which to invest, the pool's assets [12] and may employ dynamic asset allocation strategies entailing periodic replacement of, or reallocation of assets among, CTAs for the pool.

In implementing its statutory mandate to regulate the activities of CPOs and CTAs, the Commission has endeavored to refine its rules as appropriate to respond to changing market conditions in a manner consistent with customer protection.[13] The Commission's Division of Trading and Markets (''Division'') has issued relief on a case-by-case basis to facilitate application of the disclosure requirements to new market conditions not contemplated by the existing regulatory framework, such as multi-advisor and fund-of-funds structures. The objective in such cases is to apply the rules so as to foster clear and succinct disclosure of material information, especially concerning fees and other aspects of fund operations affected by such structures, taking into account the particular characteristics of the offered investment vehicle.[14] In many cases, strict application of existing disclosure requirements to pools whose CPOs have voluminous performance histories or which invest through multiple CTAs or investee funds could result in undue emphasis upon performance record disclosure and reduced focus upon more germane data. These effects have been mitigated in appropriate circumstances through grants of exemptive or no-action relief.[15]

Thus, the proposal to revise the part 4 rules reflected the Commission's experience in addressing a wide range of CPO and CTA disclosure issues under the prior rules, the evolution of the marketplace, the development of new trading structures and the views of the public and of market participants.

B. National Futures Association Proposals

As detailed in the Proposing Release,[16] on March 15, 1994, the National Futures Association (''NFA'') submitted to the Commission proposed amendments to, and interpretations of, NFA's Compliance Rules based upon the recommendations of NFA's Special Committee for the Review of CPO/CTA Disclosure Issues (''NFA's Submission''). NFA's Submission consisted of several parts, including: Proposals concerning presentation of past performance data, including proposed capsule formats for CPO and CTA performance; proposed requirements for calculation and disclosure of break-even analyses by CPOs; proposed rules for the use of hypothetical trading results by NFA members in promotional material; and proposals dealing with the use of ''nominal'' or ''notionally funded'' accounts. The proposals requiring, and providing instructions for, break-even analyses were published for public comment and subsequently approved by the Commission on April 26, 1995, substantially as proposed.[17] Rule 4.10(j)

Commission and the states, the appropriateness of a two-part format for pool Disclousre documents. *See* 59 FR 25351.

[4] 59 FR 25351. These revisions do not, however, affect the basic organizational structure of part 4. Thus, the subparts thereunder continue to apply as follows: subpart A, to definitions and exemptions (Rule 4.1 *et seq.*); subpart B, to the operations and activities of CPOs (Rule 4.20 *et seq.*); subpart C, to the operations and activities of CTAs (Rule 4.30 *et seq.*); and subpart D, to advertising (Rule 4.40 *et seq.*).

[5] 44 FR 1918, 1920 (January 8, 1979).

[6] 42 FR 9278, 9279 (February 15, 1977).

[7] 59 FR 25351, 25352 and n.7.

[8] 59 FR 25351, 25352 and n.8.

[9] 59 FR 25351, 25352 and n.9.

[10] Rule 4.10(d)(4) defines the term ''investee pool,'' discussed more fully below.

[11] 59 FR 25351, 25353 and n.11.

[12] 59 FR 25351, 25353. Rule 4.10(h) defines the term ''trading manager,'' as discussed more fully below.

[13] *See, e.g.,* Rules 4.5, 4.12(b) and 4.7, adopted in 1985, 1987 and 1992, respectively, and the discussion of those rules at 59 FR 25351, 25353.

[14] 59 FR 25351, 25353–25354. In reviewing Disclosure Documents for fund-of-funds structures, Division comment letters previously have stated that although pool documents should provide all information required by (former) Rule 4.21 for each investee pool, ''generally at the same level of detail as though the investee pool were providing its own separate disclosure document,'' nevertheless reduced disclosures are appropriate where less than twenty-five percent of the assets of the offered pool would be invested in an investee pool. The Division has also provided guidance through interpretative statements and advisories with respect to past performance presentations in Disclosure Documents. *See, e.g.,* CFTC Advisory 87–2, (1986–1987 Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶ 23, 624 (June 2, 1987), defining the term ''beginning net asset value'' for rate of return calculations; CFTC Advisory (unnumbered, dated February 27, 1991), (1990–1992 Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶ 25,005, permitting CPOs and CTAs to use alternative rate of return computation methods to more accurately reflect the return on funds available for trading during the period; and CFTC Advisory 93–13, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,554 (February 12, 1993), permitting the use of an alternative method for computing CTAs' rates of return.

As noted below (*see* n.15), the staff addresses specific requests for relief on a case-by-case basis.

[15] *See, e.g.,* CFTC Interpretative Letter No. 94–12, (Current Transfer Binder), Comm. Fut. L. Rep. (CCH) ¶ 25,993 (December 27, 1993) (capsule performance disclosure permitted for CPO's other pools; CFTC Interpretative Letter No. 94–10, (Current Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶ 25,991 (December 16, 1993) (capsule performance disclosure permitted); CFTC Interpretative Letter No. 93–107, (Current Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶ 25,899 (October 26, 1993) (CPO permitted to omit disclosures concerning its single advisor pools in Disclosure Document for a multi-advisor pool under certain conditions); CFTC Interpretative Letter No. 92–12, (1990–1992 Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶ 25,343 (July 28, 1992) (CPO permitted to omit required disclosures concerning CTAs and investee pools allocated less than 10% of pool's assets under certain conditions); and CFTC Interpretative Letter No. 92–9, (1990–1992 Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶ 25,300 (June 1, 1992) (CPO permitted to use two-part Disclosure Document with past performance of CTAs in second part delivered contemporaneously with first part) and Advisory 27–92 (June 3, 1992) (Commission has no objection to use of two-part Disclosure Document subject to conditions set forth in Interpretative Letter 92–9), issued in connection therewith. The foregoing generally are discussed at 59 FR 25351, 25353–54.

[16] *See* 59 FR 25351, 25354.

[17] NFA Compliance Rule 2–13(b) and Interpretive Notice to Compliance Rule 2–13(b). The ''break-

Continued

incorporates by reference NFA's instructions for calculating the ''break-even'' point. The portion of NFA's Submission concerning hypothetical trading results [18] was modified by NFA in response to Commission and public comments and remains under consideration.[19] Rule 4.41, revised as discussed herein, permits persons to follow either the Commission or rules adopted by NFA.

NFA's Submission included proposed rules with respect to past performance presentations, which were considered by the Commission in preparing the recommendations set forth in the Proposing Release. As noted in the Proposing Release, the portion of NFA's Submission addressing the use of ''nominal'' or ''notionally funded'' accounts was remitted to the NFA for further explanation and documentation. The Commission is not addressing the issue of ''nominal'' or ''notional'' account size in this release.

C. April 25, 1995 Roundtable Discussion

On April 25, 1995, the Commission convened a roundtable discussion led by Chairman Mary L. Schapiro, entitled ''Rethinking Past Performance Disclosure,'' to elicit input from industry, academic, end-user, regulatory and other sources with respect to public policy issues relevant to past performance disclosure, as well as technical and pragmatic aspects of past performance presentations. A number of the speakers expressed the view that past performance data alone are not directly predictive of future trading results but that past performance data provide information that is important in evaluating a contemplated pool offering or trading program. For example, patterns of volatility and other trading patterns in various market conditions may be evident.

Participants also noted the tendency for past performance data to have a potent persuasive effect, which some viewed as significantly exceeding the usefulness of such information as a basis for an investment decision. Speakers discussed the effect of such factors as the volume of performance data and the format in which performance information is provided, the utility of monthly as opposed to annual rates of return, and the extent to which meaningful benchmarks or standards are available to measure performance.[20]

D. Review of Public Comments

The Commission received thirty comment letters in response to the Proposing Release: three from persons registered as CTAs; five from persons registered as both a CPO and a CTA; two from persons registered as both a CTA and an introducing broker (''IB''); two from persons registered as futures commission merchants (''FCMs''); two from self-regulatory organizations; two from a futures industry trade organization; two from certified public accountants; nine from law firms; two from bar associations; and one from an academician.

The commenters strongly supported the rulemaking in general. Many commenters, however, advocated changes in various aspects of the proposed rules. The Commission has carefully considered the comments received and, based upon its review of the comments and its own reconsideration of the proposed amendments, has determined to adopt the revisions contained in the Proposing Release, with certain modifications, as discussed below. Comments received on the proposed amendments are discussed below in the context of the particular provisions to which they relate.

The Commission believes that the revised rules, as adopted, not only respond to the concerns of the commenters but, also, meet the regulatory objectives of this rulemaking. Notwithstanding the adoption of the rule amendments discussed herein, the Commission intends that the staff will continue to respond to requests for relief from the Part 4 rules on a case-by-case basis consistent with the objectives and principles of this rulemaking. The Commission also is exploring possible mechanisms for addressing additional CPO and CTA disclosure issues with the benefit of industry and other external input, including input from other federal and state regulators, on an ongoing basis.

II. Transitional Provisions

The revisions being announced today will become effective thirty days from the date hereof, but Disclosure Documents may be prepared, filed and used in accordance with the revised rules prior to the effective date. To facilitate the transition to compliance with the revised rules adopted herein, the Commission has determined that, for a period of six months after the effective date, it will not take enforcement action against any person solely on the basis of such person's use of a Disclosure Document prepared pursuant to the former rules rather than the revised rules. For pools that are continuously offered, amendment of the Disclosure Document is not required solely due to the rule revisions announced herein, and operators of such pools may make conforming changes as part of their next regular update.

Persons to whom the Division previously has granted exemptive or no-action relief permitting them to prepare Disclosure Documents in accordance with certain provisions of the proposed rules set forth in the Proposing Release are reminded that such relief is superseded by the revisions adopted herein, and any Disclosure Document used by any such person subsequent to the effective date of these revisions must comply with the revised rules.

III. Summary of Rule Changes

The following summary is intended to provide interested persons with information concerning significant changes to the Commission's disclosure framework and the manner in which those changes vary, if at all, from the Commission's proposals. These and all other changes to part 4 and other Commission rules are discussed below in the section-by-section analysis. For purposes of this release, the rules as in effect prior to the amendments discussed herein are referred to as the ''former'' rules.

A. Definitions [21]

Many of the proposed amendments set forth in the Proposing Release introduced new concepts into the rules. As a consequence, the Proposing Release contained several new definitions designed to modernize the rules in light of marketplace developments and to aid in implementation of the revised rules. Several of these new definitions have been adopted with modifications: ''multi-advisor pool'' (Rule 4.10(d)(2)); ''principal-protected pool,'' which was proposed as ''limited risk pool'' (Rule 4.10(d)(3)); ''trading manager'' (Rule 4.10(h)); ''major commodity trading advisor'' (Rule 4.10(i)); ''major investee pool'' (Rule 4.10(d)(5)); ''trading principal'' (Rule 4.10(e)(2)); and ''break-even point'' (Rule 4.10(j)). Two of the proposed definitions have been

even'' analysis is a computation of the trading profit that a pool must realize in the first year of an investor's participation for the investor to recoup his or her initial investment.

[18] Proposed NFA Compliance Rule 2–29(c).

[19] Separately, the Commission contemplates further review of the subject of hypothetical performance presentations to assure adequate safeguards against the misuse of such disclosure.

[20] A summary of the roundtable discussion is on file with the Commission's Office of the Secretariat.

[21] The section-by-section analysis of revised and new definitions is set forth in Section IV below.

eliminated,[22] and three additional definitions which were not included in the Proposing Release have been added: ''investee pool'' (Rule 4.10(d)(4)), ''draw-down'' (Rule 4.10(k)), and ''worst peak-to-valley draw-down'' (Rule 4.10(*l*)). As adopted, the new definitions are included in Rule 4.10, and where appropriate, related definitions have been made part of the same paragraph.[23]

B. Required Performance Disclosures [24]

1. CPO Disclosure Documents

Rule 4.25 of the amended rules creates a simplified structure for the presentation of required past performance by CPOs. In each case, the presentation must cover the five most recent calendar years and year-to-date, or the entire life of the subject pool, account or trading program, whichever is shorter. (Rule 4.25(a)(5)).

a. All required past performance presentations for pools are reduced to a summary, capsule format containing specified core information. (Rule 4.25(a)(1)). In a change from the proposal, CPOs may present monthly rates of return required for the offered pool for five calendar years and year-to-date either in tabular form or in a bar graph. (Rules 4.25(a)(1) and (a)(2)).

b. For an offered pool which meets the following criteria, the past performance record of only the offered pool itself is required to be presented in the Disclosure Document: (1) The pool has at least a three-year history of trading commodity interests; and (2) during that minimum three-year period at least seventy-five percent of the pool's assets were contributed by persons not affiliated with the CPO, trading manager, CTA or FCM for the pool, or their respective principals. (Rule 4.25(b)).

c. For offered pools which do not meet the three-year operating history criteria of Rule 4.25(b), past performance data for the offered pool, for other pools operated by (or accounts traded by) the CPO and trading manager, and for each ''major'' CTA or ''major'' investee pool is required.[25] If the CPO or trading manager has less than a three-year history in trading pools for which at least seventy-five percent of pool contributions were made by persons not affiliated with the CPO, trading manager, or CTA for the pool or their respective principals, the past performance of the CPO's (and trading manager's) trading principals[26] is required to be presented unless that performance does not differ materially from the performance of the offered pool and the CPO of the offered pool. (Rule 4.25(c)(2)).

d. The requirement in proposed Rule 4.25(c)(3)(iii) to disclose certain information under the designation ''adverse performance'' has not been adopted. However, the terms ''major commodity trading advisor'' and ''major investee pool'' have been redefined to include CTAs and investee pools with ten percent, rather than twenty-five percent, allocations of pool assets and a narrative discussion of the performance history of non-major CTAs and investee pools is required. (Rule 4.25(c)(5)).

2. CTA Disclosure Documents

Under proposed Rule 4.34(a)(1), CTAs would have been required to continue to present the performance of the offered trading program in the full multi-column tabular format previously required under Rule 4.31(a)(3). Performance of all other trading programs directed by the CTA would have been presented in the new capsule format used in CPO Disclosure Documents. As adopted, Rule 4.35(a)(1) permits CTAs to use a capsule format (similar to the capsule format adopted for CPOs) for all programs. The offered trading program's capsule must include monthly rates of return and the numbers of profitable and losing accounts in the trading program. The required monthly rates of return may be presented either in tabular form or as a bar graph, as is the case for the offered pool in a CPO Disclosure Document. As with CPO Documents, all required performance is to be presented for the five most recent calendar years and year-to-date or for the life of the trading program, whichever is shorter. (Rule 4.35(a)(5)).

C. Required Non-Performance Disclosures [27]

Required non-performance disclosures are revised as follows.

1. *Break-Even Point.* CPOs are required to disclose the pool's break-even point, indicating the trading profit the pool must realize in order for a participant to recover his entire initial investment if he redeems his interest after one year. (Rules 4.10(j), 4.24(d)(5) and 4.24(i)(6) for CPOs). The break-even point is required to be calculated in accordance with rules promulgated by a registered futures association pursuant to section 17(j) of the Commodity Exchange Act (the ''Act'').[28]

2. *Material Litigation.* Actions adjudicated on the merits in favor of persons whose litigation history is required need not be disclosed. Required disclosures concerning actions against FCMs and IBs are significantly reduced. (Rules 4.24(*l*) for CPOs and 4.34(k) for CTAs).

3. *Principal Risk Factors.* CPOs and CTAs must discuss the principal risk factors of the pool or trading program, including but not limited to volatility, leverage, liquidity and counter-party creditworthiness. (Rules 4.24(g) for CPOs and 4.34(g) for CTAs).

4. *Business Background.* Disclosure of the business backgrounds of principals is limited to principals (including officers and directors) who participate in making trading or operational decisions for the pool or CTA (or who supervise persons so engaged). Disclosure of CTA and investee pool operator business backgrounds in CPO Disclosure Documents is limited to major CTAs and major investee pools. (Rules 4.24(f) for CPOs and 4.34(f) for CTAs).

5. *Conflicts of Interest.* Rule 4.24(j) calls for a full description of actual and potential conflicts involving the CPO, the trading manager, major CTA or major pool operator and any principal thereof, as well as any person providing services to the pool or soliciting participants for the pool. The rule also calls for the disclosure of any other material conflict of interest involving the pool. Disclosure with respect to payment for order flow, soft dollar arrangements and similar arrangements is specifically called for. Rule 4.34(j) for CTAs also specifically references payment for order flow and soft dollar arrangements.

6. *Fees and Expenses.* Rule 4.24(i) requires the CPO to describe the expenses incurred in the previous year and to be incurred in the current year and to disclose fees and commissions in connection with pool solicitations. The rule also specifies significant expense categories not previously enumerated in Rule 4.21 and requires an explanation of

[22] The definition of ''adverse performance,'' which was included in proposed Rule 4.25(a)(8), and the definition of ''trading program,'' which was included in proposed Rule 4.34(a)(5), have not been adopted.

[23] Pool-related definitions are now sub-paragraphs of Rule 4.10(d) and the definition of ''trading principal'' has been included as a sub-paragraph of Rule 4.10(e).

[24] The section-by-section analysis of required performance disclosure revisions is set forth in Section V below.

[25] Rules 4.10(i) and 4.10(d)(5) define the terms ''major commodity trading advisor'' and ''major investee pool,'' respectively.

[26] The term ''trading principal'' is defined in Rule 4.10(e)(2).

[27] A section-by-section analysis of required non-performance disclosure revisions is set forth in Section VI below.

[28] 7 U.S.C. 1 *et seq.* (1994). As noted above, NFA rules governing calculations of the break-even point are included in an Interpretive Notice accompanying NFA Compliance Rule 2–13(b), which Rule and Notice the Commission approved on April 26, 1995.

the calculation of the pool's break-even point. If a fee is determined by reference to a base amount, the manner in which the base amount is calculated must be disclosed.[29] (Rules 4.10(j), 4.24(d)(5) and 4.24(i) for CPOs, and 4.34(i) for CTAs).

D. Non-Required Disclosures[30]

1. Proprietary Trading Results. As proposed and as adopted, the rules provide that proprietary trading results presented in either a CPO or CTA Disclosure Document must be labelled as such and placed at the end of the document. (Rules 4.24(v) and 4.25(a)(8) for CPOs, and 4.34(n) and 4.35(a)(7) for CTAs).

2. *Supplemental Information.* Proposed Rules 4.24(v) and 4.33(n) generally would have required that information not specifically called for by Commission rules or federal or state securities laws or regulations could only appear following the related required disclosure. The new rules, as adopted, require that any supplementally provided performance information be presented after the entire required performance presentation. Supplemental non-performance information relating to required disclosures may be included with the respective related required disclosures. Other supplemental information is required to follow the last required disclosure, and any proprietary, hypothetical, simulated or pro forma[31] trading results must be placed at the end of the Disclosure Document. Supplemental information must not mislead or obscure or diminish in prominence any required disclosure. (Rules 4.24(v) for CPOs and 4.34(n) for CTAs).

E. Format Improvements to Enhance Readability[32]

A number of revisions to the rules are intended to enhance the accessibility and prominence of relevant disclosures. Disclosure Documents are now required to contain a table of contents. Further, the number and content of various previously required bold-face ''boilerplate'' risk and cautionary statements has been reduced. Certain core information, including the break-even point, is required to be set forth in the forepart of the document. (Rules 4.24(a) through (d) for CPOs and 4.34(a) through (d) for CTAs).

A significant change from the Proposing Release is the renumbering of the CTA disclosure rules to correspond to the numbering of the CPO disclosure rules. To accomplish this, proposed Rules 4.32, 4.33, 4.34 and 4.35 have been adopted as Rules 4.33, 4.34, 4.35 and 4.36, respectively, and Rule 4.32 has been reserved.

Subject	CPO rule	CTA rule
Required delivery of Disclosure Document	4.21	4.31
Report to pool participants	4.22	.....
Recordkeeping	4.23	4.33
General disclosures required	4.24	4.34
Performance disclosures	4.25	4.35
Use, amendment and filing of Disclosure Document	4.26	4.36

F. Other Revisions[33]

The rule amendments also are designed to facilitate pool offerings, particularly with respect to areas of overlap or potential inconsistency with the rules of the Securities and Exchange Commission (''SEC''). Thus, CPOs and CTAs may now update Disclosure Documents every nine months, rather than every six months as formerly required. (Rules 4.26(a) for CPOs and 4.36(a) for CTAs.) In addition, CPOs may provide accredited investors with a notice of intended offering and statement of the terms of the proposed offering, prior to delivery of a Disclosure Document. (Revised Rule 4.21(a) for CPOs.)

G. Distribution Table

In light of the extensive substantive and organizational revisions to the content of Disclosure Documents, and therefore to the part 4 rules, the Commission is setting forth below a distribution table to assist interested persons in complying with the new disclosure framework for CPOs and CTAs.

DISTRIBUTION TABLE

Old section	New section
4.10(d)	1.55(a)(1)(iii) 4.10(d)(1) 4.10(d)(2)–(d)(5)
4.10(e)	4.10(e)(1) 4.10(e)(2) 4.10(h)–(*l*)
4.21(a)	4.21(a) 4.24(c) 4.24(d)
4.21(a)(1)(i)–(1)(vii)	4.24(d)(1)–(d)(2), 4.24(e)
4.21(a)(1)(viii)	4.24(h) 4.24(d)(3), 4.24(d)(5)
4.21(a)(2)	4.24(f) 4.24(g)
4.21(a)(3)	4.24(j)
4.21(a)(4)	4.24(n), 4.25
4.21(a)(5)	4.24(n), 4.25
4.21(a)(6)	4.24(t)
4.21(a)(7)	4.24(i)(i)–(i)(4)
4.21(a)(8)	4.24(s)
4.21(a)(9)	4.24(h)(4) 4.24(*o*)
4.21(a)(10)	4.24(p)
4.21(a)(11)	4.24(q)
4.21(a)(12)	4.24(r) 4.24(k)
4.21(a)(13)	4.24(*l*)
4.21(a)(14)	4.24(i)(5)
4.21(a)(15)	4.24(m)
4.21(a)(16)	4.24(u) 4.24(v)
4.21(a)(17)	4.24(b)
4.21(a)(18)	4.24(a)
4.21(b)	4.26(c)
4.21(c)	4.24(d)(4)
4.21(d)	4.21(b)
4.21(e)	4.26(a)
4.21(f)	4.26(b)
4.21(g)	4.26(d)
4.21(h)	4.24(w)
4.31(a)	4.31(a) 4.34(c) 4.34(d)
4.31(a)(1)(i)	4.34(d)(1)
4.31(a)(1)(ii), 4.31(a)(iv).	4.34(e)
4.31(a)(1)(iii)	4.34(h)
4.31(a)(2)	4.34(f) 4.34(g)
4.31(a)(3)	4.34(m), 4.35
4.31(a)(4)	4.34(i)
4.31(a)(5)	4.34(j)
4.31(a)(6)	4.34(*l*)
4.31(a)(7)	4.34(k) 4.34(n)
4.31(a)(8)	4.34(b)
4.31(a)(9)	4.34(a)
4.31(b)	4.36(c)
4.31(c)	4.34(d)(2)
4.31(d)	4.31(b)
4.31(e)	4.36(a)
4.31(f)	4.36(d)
4.31(g)	4.34(*o*)
4.32	4.33
4.41(b)(1)	4.41(b)(1)(A)–(b)(1)(B)

IV. Definitions

A. Major Commodity Trading Advisor: Rule 4.10(i)

In proposed Rule 4.10(k), the term ''major commodity trading advisor''

[29] Except for this provision, Rule 4.34(i) for CTAs is unchanged from the former rule.

[30] A detailed discussion of non-required disclosures is included in Sections V and VI below.

[31] However, pro forma adjustments to performance data are required for certain purposes and such adjustments are not affected by the restrictions upon placement of supplemental information. *See* Section V.C.3., *infra.*

[32] The section-by-section analysis of format improvement revisions is set forth in paragraph B.6. of Section V and in Section VI below.

[33] The section-by-section analysis of other revisions (including: Deletion of certain requirements to state that a disclosable situation does not exist; changes to the Disclosure Document amendment, filing and use requirements; and technical conforming changes) is set forth in Section VII below.

would have been defined as a CTA allocated or intended to be allocated at least twenty-five percent of the pool's aggregate initial margin and premiums for futures and commodity option contracts. The Commission requested comment concerning this proposed definition, specifically as to the use of a percentage of the pool's aggregate initial margin and premiums for futures and commodity option contracts as compared to a percentage of the pool's total assets, which was proposed in Rule 4.10(*l*) as the basis for determining whether an investee pool would be a major investee pool. The Commission asked whether the proposed distinction between the definition of major CTA and major investee pool would appropriately reflect the relative risks of direct futures trading as compared to trading through vehicles which limit the risk of loss to the initial investment.

The majority of the commenters on the major CTA definition recommended that the definition be based on the percentage of the pool's net asset value allocated to the CTA, rather than on the percentage of the pool's aggregate initial margin and option premiums. Commenters stated that it would be difficult to determine how much of the assets allocated to a CTA would be used for margin and premiums, noted that pool operators do not base allocations to CTAs on margins and premiums, and urged that the amount of assets allocated to a CTA better indicates the CTA's potential impact on the pool's performance. Several commenters suggested substitute benchmarks, including standards based on the CTA's ''trading level,'' *i.e.*, the portion of the pool's ''market exposure'' allocated to the CTA and the portion of the pool's assets committed to trading that had been allocated to the CTA. The Commission was also urged to provide expressly that pool assets allocated to a CTA include notional equity, since otherwise the standard may fail to reflect the actual portion of the pool's assets at risk with the CTA, and to use the percentage of pool assets allocated to an advisor specified in the written agreement between the advisor and the pool operator to measure the allocation amount, regardless of how such allocations are drawn upon by advisors from time to time for margin and premiums. A number of commenters expressed agreement with the proposed twenty-five percent threshold amount (while urging that it be based on pool assets).

The Commission agrees with the concept advanced or implicit in several of the comment letters that a key objective of defining major CTAs is to gauge the ability of the various CTAs for the pool to place the assets of the pool at risk. To further this objective, the Commission has adopted a revised definition of major CTA in Rule 4.10(i). Under the revised definition, the determination as to whether a CTA is a major CTA is based upon the percentage allocation to the CTA of the pool's aggregate net assets or the aggregate value of the net assets allocated to the pool's trading advisors, whichever is smaller, as determined by the agreement between the CPO and the CTA. These alternate measures are designed to assure that the major CTA definition identifies CTAs which have the ability to expose the pool's assets to significant risk because the amount of funds over which they have trading authority represents a significant proportion either of the pool's net asset value or of the aggregate value of the assets allocated to the pool's trading advisors, whichever is less.[34] As discussed more fully below, the Commission has determined to use a lower percentage threshold of ten percent in lieu of the proposed twenty-five percent threshold as part of a restructuring of the CTA and investee pool performance disclosure requirements of Rule 4.25 to eliminate the proposed category of ''adverse performance,'' which would have applied to CTAs with allocations of ten percent to twenty-five percent of the pool's futures margins and commodity option premiums.

Thus, under the alternate test being adopted in Rule 4.10(i), if, for example, the total dollar value allocated to advisors for commodity interest trading represented fifty percent of the net asset value of the pool, a trading advisor allocated ten percent of the total dollar value allocated to advisors, even though that amount would represent less than ten percent of the pool's assets, would be a major CTA.[35] This result is appropriate because the major CTA definition is designed to include CTAs who hold authority over a substantial portion of the pool's commodity interest trading, even if the absolute dollar value of the funds allocated to the CTA is relatively small compared to the total assets of the pool. Conversely, in the unlikely scenario of a CTA having an allocation that, although insignificant compared to the aggregate allocations to CTAs, is significant relative to the assets of the pool, that CTA should also be considered major. This scenario could occur if CTAs collectively are allocated more than the net asset value of the pool;[36] in such a case, a CTA might, in effect, be trading more than ten percent of the pool's assets even though his allocation represented less than ten percent of total CTA allocations. In such a case, the CTA should be considered a major CTA, thus potentially resulting in a pool having more than ten major CTAs, based upon the level of exposure of pool assets.

Because the major CTA definition is intended to identify advisors whose trading is significant to the pool in terms of overall risk, any percentage allocation figure based upon a single benchmark such as funds allocated by written or other agreement is likely to provide only a rough comparative measure. This is so because trading advisors' programs may lead to different degrees of futures or other risk exposure and different volatility patterns despite the same quantitative allocation of funds. Consequently, in determining whether a trading advisor's performance should be disclosed as material information, even if the trading advisor would not constitute a major CTA under the definition set forth in Rule 4.10(i), the pool operator should assess the likelihood that the CTA's trading, given the leverage used, may expose significantly more of the fund's net asset value in a worst case scenario than his percentage allocation level would indicate. Such a case may warrant inclusion of capsule performance information for the CTA even if his allocation does not exceed the ten percent threshold. In most cases, however, a textual discussion will suffice, and the Commission has emphasized the requirement for this type of supplementary disclosure as to non-major CTAs generally by adopting Rule 4.25(c)(5), discussed *infra*. Further, a CTA's performance may be marketed in such a manner as to render more comprehensive disclosure of his performance material, *e.g.*, the CTA may be accorded ''major'' importance by

[34] Adoption of this standard for determining a major CTA is not intended to address or relate to the use of so-called ''notional'' or ''nominal'' account sizes for purposes of calculation of rates of return.

[35] The standards discussed herein do not affect the scope of the existing exemption available under Rule 4.12(b), which provides an exemption from, *inter alia*, past performance disclosure, for pools that commit no more than ten percent of the fair market value of their assets to establish commodity interest positions and trade such commodity interests in a manner solely incidental to their securities trading.

[36] The Commission does not encourage such allocations and notes that the leverage inherent in such vehicles creates corresponding risks, which must be appropriately disclosed. The Commission notes the recent heightened recognition in the domestic and foreign regulatory communities of the risks inherent in leveraged instruments and trading vehicles.

virtue of prominent references to such CTA in promotional material.

The comments indicated, and the Commission would generally expect, that allocations to CTAs would generally be evidenced by written agreement, between the CPO (or the trading manager, if any) on behalf of the pool and the CTA, assigning a particular dollar amount of the pool's assets to be traded by the CTA. This dollar amount would be converted into a percentage using the alternate standards in Rule 4.10(i). CPOs should be prepared to document their determinations as to the status of CTAs as major or non-major for audit purposes but, in most cases, the written agreement should be sufficient.

Proposed Rules 4.10(k) and 4.10(*l*) would have required that ''major'' CTA and investee pool status be determined at the time the Disclosure Document is prepared [37] and on an ongoing basis.[38] As the Commission explained in the Proposing Release, the ''major commodity trading advisor'' and ''major investee pool'' definitions are intended to include CTAs or investee pools to whom the CPO of a pool that has not commenced trading intends to make allocations at or above the specified thresholds.[39] Similarly, any CTA or investee pool to whom the CPO of an operating pool intends to reallocate assets such that the allocations to such CTA or investee pool will total ten percent or more also would be included. One commenter recommended that the asset allocations which determine major CTA or major investee pool status only be required to be accurate as of a date not more than ninety days prior to the date of the Disclosure Document. In response, the Commission notes that, pursuant to Rule 4.26(c), the CPO must notify existing participants of changes in major CTAs and investee pools, to the extent they represent material changes, within twenty-one days and must so notify previously solicited prospective participants prior to accepting or receiving funds from such prospective participants. This can be accomplished by formally amending the Disclosure Document, ''stickering'' the document, including information in an Account Statement, or other similar means. Whether a given major CTA or investee pool change is material would depend upon a variety of factors such as the overall distribution of pool assets to CTAs and investee pools, the historical frequency of such changes and the pool's overall trading program. Substitutions of, and reallocations to, CTAs or investee pools are more likely to be material changes for a pool with one or two trading advisors, than for a pool that accesses a variety of advisors and investee pools and that redirects its assets frequently in response to changes in market conditions.

B. Major Investee Pool: Rule 4.10(d)(5)

Proposed Rule 4.10(*l*) would have defined ''major investee pool'' as an investee pool allocated or intended to be allocated at least twenty-five percent of the assets of a pool. As noted above, in contrast to the proposed definition of major CTA, which would have relied upon a percentage of the pool's initial futures margin and commodity option premiums, the major investee pool definition was based upon the percentage of the assets of the investor pool allocated to the investee pool. This distinction in the basis for determining allocations to pools was based upon the fact that investments in other pools generally expose the investor pool only to loss of the initial investment and that the full amount of the investment is required to be paid at the inception of the investment. The relative importance of investee pools to prospective pool participants is thus appropriately determined by reference to the proportion of the pool's total assets actually invested in the investee pool, and the major investee pool definition did not appear to present the same issues concerning quantification of relative risk exposure as the major CTA definition.

Commenters who addressed the major investee pool definition pointed out that ''investee pool'' was not defined in the Proposing Release or in existing Commission rules. The Commission is adopting in Rule 4.10(d)(4) a definition of ''investee pool'' as ''any pool in which another pool participates or invests, *e.g.*, as a limited partner thereof.'' The Commission is adopting as Rule 4.10(d)(5) a definition of ''major investee pool'' that differs from the proposal in that it specifies that the allocation threshold is ten percent of the *net asset value* of the pool, instead of twenty-five percent of the assets of the pool. This modification was made in order to make the allocation measure consistent with the capsule performance format, which calls for net asset value. As in the case of the major CTA definition, the proposed twenty-five percent threshold has been reduced to ten percent in light of the elimination of the proposed ''adverse performance'' disclosure requirement for CTAs and investee pools with allocations ranging from ten to twenty-five percent. One commenter noted that in determining the percentage of a pool's assets allocated to an investee pool, as with CTA allocations, notional equity should be included in order to capture the risk exposure created by the investee pool's trading. This approach was advocated because the percentage of the offered pool's assets used to purchase the participation in an investee pool may not reflect the additional risk created where the assets of the investee pool are traded at a leverage factor that results in trading exposure of, for example, twice the actual assets of the investee pool. Although the Commission does not believe that this consideration warrants express treatment in the major investee pool definition, it recognizes that there may be applications of the major investee pool definition, as in the case of CTA allocations, where the basic benchmarks used in the rule do not capture all of the investee pools that may be of major impact on the offered pool. In such cases, i.e., where the investee pool is traded on a highly leveraged basis, the pool operator should be mindful of the obligation to disclose all material information and should take into consideration the nature of the investee pool's trading in determining whether it should be treated as a major investee pool for disclosure purposes.

The time at which major investee pool status is determined is discussed in paragraph A, above.

C. Multi-Advisor Pool: Rule 4.10(d)(2)

Proposed Rule 4.10(h), the multi-advisor pool definition, would have employed a twenty-five percent *or greater* allocation standard based on the pool's aggregate initial margin and premiums for futures and commodity option contracts. Thus, as proposed, the ''multi-advisor pool'' definition effectively would not have applied if a pool had one major CTA or major investee pool, and the minimum number of CTAs in a multi-advisor pool would have been five. Two commenters asserted that any pool with two or more CTAs should be considered a multi-advisor pool, although one commenter acknowledged that a pool that allocated ninety percent of its assets to one CTA should not qualify as a multi-advisor pool. As adopted, the definition of ''multi-advisor pool'' in Rule 4.10(d)(2) is a pool in which no CTA is allocated or intended to be allocated more than twenty-five percent of the pool's funds available for commodity interest trading

[37] The definitions adopted in Rules 4.10(i) and 4.10(d)(5) include CTAs and investee pools ''allocated or intended to be allocated * * *''

[38] Rule 4.26(c) requires distribution of corrections of any material inaccuracies to all participants within twenty-one days of the date on which the CPO knows or has reason to know of the inaccuracy.

[39] 59 FR 25351, 25357.

and in which no investee pool is allocated or intended to be allocated more than twenty-five percent of the pool's net assets. (Rule 4.10(d)(2)). In determining whether a CTA has been allocated more than twenty-five percent of the pool's funds available for commodity interest trading, the alternate standard in the major CTA definition should be used, *i.e.*, the percentage allocation is the amount of funds allocated to the trading advisor by agreement with the CPO, expressed as a percentage of the lesser of the aggregate value of the assets allocated to the pool's trading advisors or the net assets of the pool at the time of allocation.

D. Principal-Protected Pool: Rule 4.10(d)(3)

The term ''limited risk pool'' was defined in proposed Rule 4.10(i) as a pool (commonly referred to as a ''guaranteed pool'') that is designed to limit the loss of the initial investment of its participants. Commenters pointed out that most pools are formed as limited partnerships, thus limiting at least some of the participant's risk. Other commenters offered alternative terms [40] or suggested that the definition specify that loss would be limited by guaranty, letter of credit or other third-party undertaking. As adopted in Rule 4.10(d)(3), the term has been redesignated ''principal-protected pool,'' but the definition is unchanged from that set forth in the Proposing Release.

E. Trading Manager: Rule 4.10(h)

As proposed in Rule 4.10(j), and as adopted in Rule 4.10(h), the ''trading manager'' of a pool is defined as any person other than the pool's CPO with authority to allocate pool assets to CTAs or investee pools. Rule 4.10(h) further makes clear that sole or partial authority will bring a person within the trading manager definition.

No comments addressing the trading manager definition were received. Commission rules have not previously expressly taken account of pool structures in which a trading manager, rather than the pool's CPO, allocates pool assets. The Commission emphasizes that trading managers are CTAs and are required to be registered as such. Thus, although trading managers do not function as direct traders for the pool, they have the ability to influence the pool's trading to a very significant degree. Due to the importance of the role of trading manager, in a number of contexts the proposed rules would have made disclosure of the trading manager's performance a substitute for that of the CPO. However, as noted below, the Commission has revised the proposed rules to require disclosure both as to a pool's CPO and the trading manager, if any, in a number of contexts, *e.g.*, conflicts of interest, on the ground that in the vast majority of cases, even if the CPO has delegated substantial responsibility to the trading manager to hire and monitor CTAs, the CPO retains ultimate responsibility for operation of the pool. However, with respect to past performance disclosure, if the CPO has completely delegated trading authority to a trading manager and the past performance of the trading manager does not differ materially from that of the commodity pool operator, only the trading manager's past performance is required to be disclosed.

F. Trading Principal: Rule 4.10(e)(2)

A ''trading principal'' would have been defined in proposed Rule 4.10(m) as a principal of a CPO or CTA who participates in making commodity interest trading decisions for a pool or client or who supervises, or has authority to allocate pool assets to, persons so engaged. The sole commenter who addressed this definition urged that it be limited to principals who make trading decisions, excluding principals who supervise or hire traders. The Commission notes, however, that persons who select or supervise traders effectively determine how a pool's or client's assets will be traded. Accordingly, where disclosure of information concerning traders is appropriate, the same information should be required of those who supervise or hire them. As adopted in Rule 4.10(e)(2) only grammatical changes were made to the definition of ''trading principal'' in proposed Rule 4.10(m).

G. Break-Even Point: Rule 4.10(j)

In order to make the impact of costs and fees on an investment more understandable to the prospective investor, the Commission proposed that the narrative discussion of fees and expenses be supplemented by presentation of the ''break-even point'' for an offered pool and a clear explanation of how that break-even point is calculated. Proposed Rule 4.10(n) would have defined ''break-even point'' as the trading profit that a pool or trading program must realize in its first year to equal all fees and expenses such that a participant or client will recoup its initial investment, as calculated pursuant to rules promulgated by a registered futures association.[41]

Many commenters supported the proposal to require disclosure of a pool's break-even point.[42] However, comments on the break-even point (and the requirement to disclose the relevant calculations) indicated some confusion regarding whether the break-even point is based on the pool's first year of operation or an investor's first year of participation in the pool. For ongoing pool offerings, commenters suggested that the break-even point be optional after the first year of a pool's operation, that it be based on a prior year's actual results, or that a range of break-even points be permitted keyed to various total offering sizes.

As adopted, Rule 4.10(j) defines the term ''break-even point'' as the trading profit that a pool must realize in the first year of a participant's investment to equal all fees and expenses such that the participant will recoup its initial investment. The break-even point is required to be calculated pursuant to rules promulgated by a registered futures association and it must be expressed both as a dollar amount and as a percentage of the minimum unit of initial investment. The proposed definition referred to the trading profit that a pool or trading program must realize in the pool or trading program's first year, and the break-even point was not expressly required to be presented as a dollar amount.[43]

The Commission is clarifying that the break-even point must present the trading profit that the pool must realize in the first year of an investor's participation in order for the investor to recoup his initial investment, and Rule 4.10(j) as adopted so states. As noted above, Rule 4.10(j) provides that the break-even point must be calculated pursuant to rules promulgated by a registered futures association. NFA's Interpretive Notice accompanying its Compliance Rule 2–13(b) sets forth the manner in which the break-even point must be calculated and includes a sample break-even presentation. The amount of trading profit required for the

[40] Suggested options included ''capital protected pools'' and ''principal return guaranteed pools.''

[41] Proposed Rule 4.10(n) would also have required that the break-even point be expressed as a percentage of the minimum unit of initial investment based upon assumed redemption of the initial investment at the end of the first year of investment.

[42] Comments addressing the manner of calculating the break-even point are discussed below with Rule 4.24(i) (''Fees and Expenses'') in paragraph B.5. of Section VI.

[43] Rule 4.10(j) omits the reference in the proposed rule to ''trading program'' and ''client.'' A break-even point is not required for CTA Disclosure Documents, as CTA clients generally are subject to a much simpler fee and expense structure than are pool participants.

net asset value per unit of participation after one year to equal the initial selling price per unit is expressed both as a dollar amount and as a percentage of the initial selling price per unit. The Commission based its approval of NFA's amendment to Compliance Rule 2–13 and accompanying Interpretive Notice on, among other things, the understanding that NFA would amend the Interpretive Notice to clarify that the CPO of a continuously-offered pool must include an updated break-even analysis in the pool's Disclosure Document throughout the pool's existence, such that each new participant would be informed of a break-even point that was accurate as of the date of the Disclosure Document.[44] Revision of the break-even point is thus required for ongoing pool offerings whenever the actual break-even point becomes materially different from that which appears in the Disclosure Document.

H. Draw-Down and Worst Peak-to-Valley Draw-Down: Rules 4.10 (k) and (l)

Commenters noted that although the capsule performance presentation format in proposed Rules 4.25 and 4.34 required registrants to disclose the largest monthly draw-down and the worst continuous peak-to-valley draw-down for the pool or account, the term ''draw-down'' was not defined. To address this concern, the Commission is adopting as Rule 4.10(k) a definition of ''draw-down'' as ''losses experienced by a pool or account over a specified period.'' Similarly, the Commission has adopted Rule 4.10(l), which defines the ''worst peak-to-valley draw-down,''[45] as the greatest cumulative percentage decline in month-end net asset value due to losses sustained by a pool, account or trading program during a period in which the initial month-end net asset value is not equaled or exceeded by a subsequent month-end net asset value. The worst peak-to-valley draw-down 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 the draw-down. For purposes of Rules 4.25 and 4.35, a peak-to-valley draw-down which began prior to the beginning of the most recent five calendar years is deemed to have occurred during such five-calendar-year period.

V. Performance Disclosures: Section-by-Section Analysis[46]

A. Introduction

As noted above, the Commission is revising and reorganizing the CPO/CTA disclosure rules with a view towards simplification of presentation. Rules 4.21 and 4.31 continue to require CPOs and CTAs, respectively, to deliver a Disclosure Document.[47] Rules 4.24 with respect to CPOs, and 4.34 with respect to CTAs, set forth requirements concerning disclosure of all matters other than past performance, and Rules 4.25 for CPOs and 4.35 for CTAs set forth past performance disclosure requirements.[48]

As proposed and as adopted, past performance disclosure requirements are being substantially condensed with the objective of eliminating required disclosure of performance that is of secondary relevance to the offered pool or trading program. Thus, the revised rules provide a new ''capsule'' format for performance record presentations that is intended to provide a simple, balanced and succinct overview of performance. Use of the capsule format should substantially reduce the volume of performance data presented without sacrificing material content.

With respect to past performance in CPO Disclosure Documents, the revised rules focus primarily upon the historical performance of the offered pool. Where the offered pool has a three-year trading history and meets certain contribution criteria as specified in Rule 4.25(b), its past performance generally is the only required performance presentation. (Rule 4.25(b)).

Where the offered pool does not have the requisite operating history, the CPO must present performance data for the offered pool, for the CPO (and trading manager, as applicable), and the pool's major CTAs and investee pools. (Rules 4.25 (c)(2) through (c)(4)). A textual discussion of relevant performance factors for non-major CTAs and investee pools also is required. (Rule 4.25(c)(5)). Some performance data may be presented on a composite basis. (Rule 4.25(a)(3)). All performance data may be presented in a capsule format.

With respect to CTA Disclosure Documents, the performance of the offered trading program is the primary focus. (Rules 4.35 (a)(1) and (a)(2)). The performance of accounts traded pursuant to other trading programs of the CTA may be presented in single composite, provided the rates of return are not materially different, material differences among the accounts included in the composite are disclosed, and the composite presentation is not misleading. (Rule 4.35(a)(3)).

As the volume of required performance disclosures for both CPOs and CTAs is being considerably reduced, the time period for these disclosures is being increased from three years to five years in order to provide investors with a better chronological perspective of the performance records presented in the Disclo- sure Document. (Rule 4.25(a)(5) for CPOs and Rule 4.35(a)(5) for CTAs). This approach accords with the views of the NFA Special Committee for Review of CPO/CTA Disclosure Issues.[49]

B. Required Performance Disclosures[50]

1. Required Performance Disclosures in CPO Disclosure Documents: Rule 4.25

The new summary format for presentation of past performance history is intended to capture the most significant information concerning a pool's performance in a reader-friendly, largely nontabular form. This format will generally permit multiple track records to be provided on a single page. The new format is set forth in Rule 4.25(a)(1) for pool documents and Rule 4.35(a)(1) for CTA documents.[51]

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[44] The Commission also reminded NFA that in explaining and enforcing member compliance with NFA break-even analysis requirements the fee and expense categories in the Interpretive Notice to Compliance Rule 2–13(b) should not be considered exhaustive or exclusive, and that NFA should ensure that CPOs do not use that listing to avoid including a cost in the pool's break-even analysis. With respect to interest income, the Commission stated its understanding that NFA would require inclusion in the break-even analysis of a projection of a pool's expected interest income at an assumed interest rate reflecting then current cash market conditions, and it stated that to the extent that a person other than a pool participant receives any portion of the pool's interest income, such payment should be disclosed as a fee or expense in the pool's break-even analysis.

[45] As discussed in paragraph B.1. of Section V below, the word ''continuous'' has been omitted from the capsule item ''worst continuous peak-to-valley draw-down'' in proposed Rule 4.25(a)(1)(i)(G) and from the item ''worst ever continuous peak-to-valley draw-down'' in proposed Rule 4.25(a)(1)(ii)(F).

[46] Tables summarizing past performance disclosure requirements under the revised rules and demonstrating the use of the new capsule format are set forth below at paragraph B.7. of this Section V.

[47] Requirements with respect to the use, amendment and filing of the Disclosure Document are now contained in new Rules 4.26 for CPOs and 4.36 for CTAs, discussed more fully below at Section VII.

[48] Captions have been added to the subparagraphs of Rules 4.25 (a), (b) and (c) and Rules 4.35 (a) and (b) to increase ease of reference.

[49] NFA's Submission at 7.

[50] To facilitate understanding of the new performance requirements, paragraph B.7., *infra*, provides: (1) A table summarizing the past performance requirements of Rules 4.25 and 4.35; and (2) examples of capsule performance presentation under the rules.

[51] As discussed more fully below, the Commission has determined to permit CTA

a. Capsule Performance Presentation: Rule 4.25(a)(1)[52]

CPOs

As proposed in Rule 4.25(a)(1)(i), the capsule for pool performance in CPO Disclosure Documents would have been required to contain the following information: The name of the pool; a statement as to whether the pool is privately offered pursuant to the Securities Act of 1933, as amended (the ''Securities Act''),[53] a multi-advisor pool or a principal-protected pool; the date when the pool commenced trading; the aggregate gross capital subscriptions to the pool; the pool's current net asset value; the ''largest monthly draw-down''; the ''worst continuous peak-to-valley draw-down''; and annual and year-to-date rates of return, computed on a monthly compounded basis,[54] for the preceding five calendar years and year-to-date (or for the life of the pool if shorter). In the case of the offered pool's capsule, monthly rates of return would have been required for the entire performance period.

Similar data would have been required in capsule presentations of the performance of accounts in CPO Disclosure Documents. Proposed Rule 4.25(a)(1)(ii) would have called for inclusion in the capsule format of: The name of the CTA or other person trading the account and the name of the trading program; the date when the CTA began trading client funds and the date of inception of trading for the trading program being disclosed; the number of accounts in the program as of the Disclosure Document date; the total assets under the management of the CTA and in the trading program; the ''largest monthly draw-down'' for the program; the ''worst ever continuous peak-to-valley draw-down'' for the trading program; and annual and year-to-date rates of return for the offered trading program (again, computed on a monthly compounded basis).

CTAs

As proposed, Rule 4.34(a)(2) would have required all performance presented in CTA Disclosure Documents, with the exception of the performance of the offered trading program, to follow the capsule format as specified in Rule 4.25(a)(1)(ii) (C) through (G).

Comments. Commenters expressed uniformly strong support for the proposed new capsule format for past performance disclosure. One commenter, however, recommended that the revised rules expressly permit a CPO to continue to present performance in the multi-column tabular format required by former Rule 4.21(a)(4). Many commenters requested that the Commission define the term ''draw-down,'' as used in the proposed capsule format. Commenters also noted that use of the word ''continuous'' in the capsule item ''worst continuous peak-to-valley draw-down'' could be read to mean that any intermediate upward movement terminates the draw-down, thus permitting a small ''uptick'' to disguise the true magnitude of a long draw-down, since the uptick would break the continuity but not the decline in asset value. Suggested alternatives were ''worst absolute peak-to-valley draw-down'' and ''worst peak-to-valley period.'' One commenter sought confirmation that the proposed rule would require disclosure of the number of successive months during which net asset value failed to exceed the pool's prior high water mark and the total percentage decline over that period.

Numerous commenters criticized the proposed requirement that monthly rates of return be presented for the offered pool over the entire five-year performance period (or for the life of the offered pool if less than five years), claiming that such data would detract from the simplicity and clarity of the capsule format. One commenter contended that monthly rates of return are not relevant to a medium to long-term investment such as managed futures. Various alternative indicators of volatility were proposed in lieu of monthly rates of return, including the pool's standard deviation over its life, the best and worst monthly and annual returns, and the number of profitable and losing months. One commenter recommended that the capsule also include such information as largest monthly increase and greatest valley-to-peak increase in order to provide a balanced presentation. A number of commenters urged the Commission to resolve the issue of the use of notional funds and nominal account sizes in performance presentations.[55]

The Commission requested comment as to whether past performance presentations would provide more meaningful information if they were required to include rates of return on a risk-adjusted basis, that is, reduced by the relevant Treasury Bill rate or comparable interest figure, or to break out trading results from passive interest income. The only commenter specifically addressing this request expressed the view that risk-adjusted rates of return would not make performance presentations more meaningful and contended that indexing performance based upon another form of investment implied that participation in a commodity pool was somehow comparable to such other investment.

Technical Changes to Capsule

The Commission is adopting the capsule format for performance presentations in pool Disclosure Documents, with certain technical modifications as noted below. In adopting the capsule performance format, the Commission stresses that this summary format is designed for purposes of presentation in Disclosure Documents only. CPOs and CTAs must continue to compute performance on the same basis as under the former rules[56] and to maintain records substantiating such computations in accordance with Rule 1.31.[57] The Commission is not adopting at this time a requirement that registrants present past performance on a risk-adjusted basis.

Draw-Down Information

The required draw-down information, which is based upon activity occurring for the most recent five calendar years and year-to-date, is intended to inform prospective participants of the nature of the volatility actually experienced by the pool by demonstrating the significant one-month and sustained declines to which the commodity pool

documents to present the past performance of the offered trading program in the new capsule format.

[52] Rule 4.10(k), which defines the term ''draw-down,'' and Rule 4.25(a)(7), relating to substantiating past performance calculations, are also discussed in this section.

[53] For this purpose private offerings may be pursuant to section 4(2) of the Securities Act of 1933, as amended, 15 U.S.C. 77d(2), or Regulation D thereunder, 17 CFR 230.501–230.508 (1994).

[54] *See* Rule 4.25(a)(1)(i)(H). Annual rates of return computed on a monthly compounded basis assume reinvestment of accrued profits and therefore the investment base on which rates of return are calculated is effectively adjusted by these amounts.

[55] As noted above, the Commission is reviewing the subject of ''notional funds'' performance data with the benefit of industry, end-user, regulatory and academic input provided at the Commission's April 25, 1995, roundtable discussion and other available data.

[56] Although only the amounts specified in Rules 4.25(a) (1) and (2), and Rules 4.35(a) (1) and (2) need be set forth in the Disclosure Document, the same performance calculations as previsouly required must be made, as specified in Rule 4.25(a)(7) for CPOs and Rule 4.35(a)(6) for CTAs, as such rules may be interpreted by the Commission. The corresponding former rules are former Rule 4.21(a)(4)(ii) and former Rule 4.31(a)(3)(ii), respectively.

[57] Among other things, Rule 1.31 requires all books and records to be maintained for a period of five years and to be available for inspection by any representatives of the Commission or the U.S. Department of Justice. CTAs also are subject to those requirements.

has actually been subject. To ensure that the worst long-term draw-down is properly represented, Rules 4.25(a) and 4.35(a), as adopted, require the capsule to include the ''worst peak-to-valley draw-down,'' eliminating the qualification ''continuous.'' [58]

The Commission also is adopting definitions of the terms ''draw-down'' and ''worst peak-to-valley draw-down.'' Rule 4.10(k) provides that ''draw-down'' means losses experienced by a pool or account over a specified time period. Thus, a draw-down is a decline in net asset value due to reasons other than redemptions or withdrawals. To assist readers who may not be familiar with industry terminology, the Commission has also added a requirement that the capsule format include, in a footnote or otherwise, a definition of the term ''draw-down'' that is consistent with the definition set forth in Rule 4.10(k). Rule 4.10(*l*) defines ''worst peak-to-valley draw-down'' as the greatest cumulative percentage decline in month-end net asset value due to losses sustained by a pool, account or trading program 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. The rule specifies that the worst peak-to-valley draw-down 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. For purposes of the revised rules, a peak-to-valley draw-down which began prior to the beginning of the most recent five calendar years is deemed to have occurred during such five-calendar-year period.

Both monthly and peak-to-valley draw-down amounts are to be expressed as a percentage of the net asset value at the beginning of the specified period. The largest monthly draw-down indicates the largest net asset loss experienced by the pool in any calendar month, and the month and year in which that loss occurred. The worst peak-to-valley draw-down indicates the largest calendar month-to-calendar month net asset loss experienced by the pool during any period and the months and year in which it occurred. Dating the monthly and peak-to-valley draw-downs permits participants to assess whether the losses were connected to market conditions by comparing the draw-downs of several pools. As explained in the Proposing Release,[59] a peak-to-valley draw-down of 4 to 8–91/25% would indicate that the peak-to-valley lasted from April to August of 1991 and resulted in a twenty-five percent draw-down of the pool's net asset value.

Monthly Rates of Return

The Commission has determined to modify the proposal with respect to monthly rates of return for the offered pool to permit flexibility as to the form of presentation. As adopted, Rule 4.25(a)(2) provides that the capsule for the offered pool must contain monthly rates of return for the five most recent calendar years and year-to-date (or the pool's life, if shorter) presented either in tabular form or in a bar graph. If a bar chart is used, the bar chart must clearly indicate monthly rates of return and must also prominently indicate annual rates of return. Rule 4.25(a)(2)(iv) requires that the CPO make available upon request to prospective and existing participants the supporting data necessary to calculate monthly rates of return for the offered pool as specified in Rule 4.25(a)(1).

The Commission notes that registrants may present performance information in the multi-column format specified by former Rule 4.21(a)(4) *in addition to* the capsule format specified by Rule 4.25(a)(1), provided that any performance presented in the superseded format is treated as supplemental information and is placed following all of the required performance disclosures in the Disclosure Document.[60]

Registrants who offer notional programs may disclose monthly rates of return in the capsule disclosure for CTA programs using the fully-funded subset described in Advisory 93–13.[61] Commission staff will provide guidance concerning supplemental data to accompany the capsule disclosure to reflect the range of levels of partial funding and the generic disclosures discussed in Advisory 93–13.

b. Pools With Three or More Years Operating History That Meet Contribution Criteria: Rule 4.25(b) [62]

As proposed, Rule 4.25(b) would have limited required performance disclosures in pool Disclosure Documents to the offered pool's performance if: (1) The pool had traded commodity interests for three years or more, (2) no fewer than fifteen pool participants were unaffiliated with the CPO, and (3) no more than ten percent of the pool's assets were contributed by the CPO. As stated in the Proposing Release, the Commission believes that, generally, ''where a pool has an extensive operational history, presentation of the pool's own past performance record should fulfill the objectives of past performance disclosure.'' [63] If, however, the pool's past performance record was accrued under conditions that differed materially from those which will obtain prospectively, the pool's historical performance record alone may not be sufficient. For example, if the pool's past performance record encompasses periods when the pool was essentially a proprietary trading vehicle investing a relatively small amount of funds contributed by third party sources, the performance record generated may have little or no relevance to a publicly offered pool.[64] Accordingly, to assure that the three-year performance history would not represent the performance of a significantly dissimilar trading vehicle, the Commission proposed to limit past performance disclosure to the past performance of only the offered pool where, and only where, the pool

[58] The word ''continuous'' is eliminated from Rules 4.25(a)(1) (i)(G) and (ii)(F), and the extraneous word ''ever'' is eliminated from Rule 4.25(a)(1)(ii)(F).

[59] 59 FR 25351, 25356.

[60] This statement also applies to CTAs. *See* Rule 4.24(v) for CPOs and Rule 4.34(n) for CTAs, concerning supplemental disclosures, discussed in paragraph C.1. of this Section V.

[61] CFTC Advisory 93–13, (Current Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶ 25,554 (February 12, 1993). Advisory 93–13 requires that CTAs who manage or offer to manage partially-funded (''notionally'' funded) accounts present both actual and nominal funds under management and give certain disclosures in connection with partially-funded accounts. The Advisory also provides a method for presenting rates of return for a trading program in a single table on the basis of a ''fully funded subset'' of accounts within that trading program.

[62] Former Rule 4.21(a)(4) required disclosure of the performance record of the offered pool. If the offered pool had less than a twelve-month performance history, the performance of the CPO and of each of its principals was also required to be disclosed. Former Rule 4.21(a)(5) also required disclosure of the past performance of all other accounts directed by the pool's CTA and each of its principals, regardless of the duration of the pool's operating history.

[63] 59 FR 25351, 25356.

[64] *See* Elton, Gruber and Rentzler, *New Public Offerings. Information and Investor Rationality: The Case of Publicly Offered Funds,* 62 J. Bus. 1 (1988); and Edwards and Ma, *Commodity Pool Performance: Is the Information Contained in Pool Prospectuses Useful?,* Working Paper Series No. 16, Center for the Study of Futures Markets, Col. Bus. Sch. (January 1988). *See also, Statement of the Commodity Futures Trading Commission Regarding Disclosure by Commodity Pool Operators of Past Performance Records and Pool Expenses and Request for Comments,* 54 FR 5597, (February 6, 1989); and companion release of the Securities and Exchange Commission, *Statement of the Commission Regarding Disclosure by Issuers of Interest in Publicly Offered Commodity Pools,* 54 FR 5600 (February 6, 1989).

had a three-year trading history with at least fifteen unaffiliated participants and no more than ten percent participation by the CPO.

The Commission requested comment as to whether, where the offered pool has a three-year operating history, that performance record is generally sufficient without supplementary performance data concerning the pool's CTAs or other pools operated by the CPO. Three of the nine commenters who responded to the Commission's request agreed with the proposal, stating that if a pool has a three-year history, only its own past performance should be required. Six of the nine recommended that the twelve-month standard of former Rule 4.21(a)(4), which related to the presentation of other pools operated by the CPO, should be used to identify pools for which only the performance of the offered pool is required.

The Commission also sought comment as to whether the offered pool's operating history should be considered for purposes of the three-year minimum if such history was acquired when the pool differed in some material respect from the pool as offered, for example, in cases in which the pool's CTA, types of interests traded or the trading program had been significantly modified or the pool was initially privately offered but subsequently was offered to the public. All but one of the persons who responded to this request stated that material differences should be disclosed but should not disqualify a pool from meeting the three-year criteria of the rule.

Several commenters suggested elimination or modification of the requirement that the requisite three-year operating history be obtained when the pool had at least fifteen unaffiliated participants. Commenters warned that pools with high minimum investments (and few participants) would be unjustly penalized by this restriction. Several commenters recommended that the requirement that the CPO have contributed no more than ten percent of the pool's assets be modified to increase the permissible level of CPO participation, *e.g.*, to fifty percent, and two commenters noted that this would harmonize with the fifty percent standard in proposed Rule 4.25(a)(9) for determining whether past performance results must be treated as proprietary trading results for the purpose of separating such results from other past performance information.[65] Several commenters contended that Rule 4.25 as proposed would have the undesirable effect of discouraging CPOs from investing in the pools they operate. Three commenters proposed adopting either the CPO investment test or the unaffiliated participant test.

The Commission has adopted Rule 4.25(b) with several modifications to afford greater flexibility in its application. The requirement that the pool have had no fewer than fifteen participants unaffiliated with the pool operator has been eliminated and the maximum level of contribution of assets by the CPO has been increased. As adopted, Rule 4.25(b) provides for past performance disclosure to be limited to that of the offered pool if both of the following criteria are met: (1) The pool has traded commodity interests for at least three years; and (2) during the three-year (or greater) period, at least seventy-five percent of the pool's assets were contributed by persons unaffiliated with the CPO, the trading manager (if applicable), the pool's CTAs, or any of their principals.

The performance of an offered pool which has the requisite three-year operating history is required to be disclosed for five full calendar years and year-to-date or, if the pool has less than a five-year history, for the pool's entire operating history,[66] in the specified capsule format.[67] The CPO is free to include additional performance information, subject to the provisions relating to supplemental disclosures.[68]

The Commission notes that the twelve-month standard in former Rule 4.21(a)(4) related only to disclosure of the performance of other pools operated by the CPO and did not affect former Rule 4.21(a)(5)'s requirement to disclose the performance of the CTAs for the pool. Under Rule 4.25(b), if the offered pool has the requisite three-year operating history, neither the performance of the CPO's other pools *nor* the performance of the pool's CTA(s) must be presented. In view of the elimination of all other performance data, including CTA performance under the new disclosure framework, the Commission believes that a three-year rather than a one-year history is the appropriate minimum.

The Commission agrees that material differences in the operation or structure of the pool during the three years, given appropriate disclosure, generally should not disqualify the pool from satisfying the three-year criteria. However, registrants should exercise caution in cases in which such differences exist, taking into account that the requirement to disclose all material information includes past performance disclosure and thus that where significant changes in the offered pool might cause presentation of the offered pool's past performance by itself to be misleading, additional performance disclosure may be required.

The Commission believes that the different purposes of Rule 4.25(a)(8), which defines proprietary trading results and requires appropriate placement and labelling of such results, and of Rule 4.25(b), which identifies pools for which no performance history other than that of the offered pool is required, warrant different standards as to the relevant amount of proprietary participation. A more stringent limitation upon qualifying pools is appropriate for use in Rule 4.25(b), which eliminates the necessity for certain otherwise required disclosures, as compared to that of proposed Rule 4.25(a)(8). Unlike Rule 4.25(b), which identifies pools for which no additional performance data other than that of the offered pool is required, Rule 4.25(a)(8) determines the percentage at which proprietary participation essentially renders a trading vehicle a proprietary vehicle, the trading results for which were obtained under conditions that render the performance data presumptively inappropriate for inclusion with and, indeed, potentially misleading if included with, the performance of the offered pool.

c. Pools With Less Than A Three-Year Operating History: Rule 4.25(c)[69]

Disclosure Documents for offered pools that do not satisfy the criteria of proposed Rule 4.25(b) would have been required under proposed Rule 4.25(c) to include the performance records of the offered pool, each other pool operated or account traded by the CPO (or trading manager), the CPO's (or trading manager's) trading principals if the CPO (or trading manager) had less than a three-year history, and the performance of each ''major'' CTA and ''major''

[65] Proposed Rule 4.25(a)(9), adopted as Rule 4.25(a)(8), is discussed at paragraph C.2. of this Section V.

[66] Rule 4.25(a)(5).

[67] Rule 4.25(b). As adopted, the text of Rules 4.25(b) and 4.25(c) is being amended to clarify that where the offered pool meets the criteria of Rule 4.25(b), the CPO is required to present only the offered pool's performance. Where the offered pool does not meet the Rule 4.25(b) criteria, the CPO must provide additional performance disclosure as detailed in Rule 4.25(c).

[68] *See* Rule 4.24(v).

[69] Rule 4.25(c) employs certain key terms, ''trading manager,'' ''major commodity trading advisor,'' ''major investee pool,'' and ''trading principal,'' which are defined in Rules 4.10(h), 4.10(i), 4.10(d)(5) and 4.10(e)(2), respectively. These definitions are discussions in detail in Section IV, *supra*.

investee pool.[70] Disclosure of ''adverse performance'' results would have been required to be indicated (or in the alternative, capsule performance could have been presented) for non-major CTAs allocated at least ten percent of the pool's initial margins and commodity option premiums and for investee pools allocated at least ten percent of the pool's assets.[71]

Adverse performance was defined in proposed Rule 4.25(a)(8) as ''any annual return of one hundred basis points less than the ninety day Treasury Bill rate on December 31 of the calendar year in which the performance occurred or any termination of a pool pursuant to a loss termination provision.''

The Commission received comments on various components of Rule 4.25(c). A number of commenters urged the Commission to eliminate the proposed intermediate category for CTAs and investee pools [72] for whom adverse performance disclosure would have been required and to adopt a two-tier system in which full performance disclosure would be made for CTAs (and investee pools) above the threshold, and none for CTAs (and investee pools) below the threshold. Several commenters suggested that where a CPO makes (and is authorized to make) frequent changes in the pool's CTAs and the size of the allocations to those CTAs, required disclosures with respect to CTAs should be eliminated or substantially reduced. The emphasis in such cases, according to these commenters, should be on the CPO/trading manager's performance operating multi-advisor pools. The Commission notes, however, that the distinction between ''active allocation'' CPOs (or trading managers) and other CPOs (or trading managers) does not appear to be susceptible to a bright line test, as most if not all CPOs and trading managers assume some responsibility for ongoing management and evaluation of CTAs. Consequently, the relative significance of the CPO's or trading manager's asset allocation expertise, as compared to the CTAs' trading program and skills, varies significantly and may not provide an objective basis for distinguishing among pools for past performance disclosure purposes. Accordingly, given the lack of precise standards on which to base a regulatory distinction between dynamically managed multi-advisor pools and other types of pools, the Commission has elected not to employ such a distinction in constructing the past performance disclosure requirements.

As adopted, Rule 4.25(c) reflects several modifications from the proposed rules, principally the elimination of the category of CTAs and investee funds for which disclosure of adverse performance would have been required. Upon consideration of the comments received, the Commission has determined to simplify the disclosure requirements such that all CTAs and investee funds will be either major and capsule format presentations of their past performance required (Rule 4.25 (c)(3) and (c)(4)), or non-major and a narrative discussion of matters relevant to their past performance required. (Rule 4.25(c)(5)). As noted above, the definitions of ''major commodity trading advisor'' (Rule 4.10(i)) and ''major investee pool'' (Rule 4.10(d)(5)) have been revised accordingly, such that a ten percent, rather than a twenty-five percent allocation is the operative threshold.

With respect to pools that do not have the requisite three-year operating history with at least seventy-five percent of the pool's assets contributed by persons unaffiliated with the CPO, trading manager, CTAs, or their respective principals, Rule 4.25(c) requires presentation of the past performance records of the offered pool, each other pool operated or account traded by the CPO (and trading manager, if applicable), the CPO's (and trading manager's) trading principals if the CPO (or trading manager) has less than a three-year history, and the performance of each major CTA and major investee pool.[73] If a CTA or investee pool is not ''major,'' a summary description of the performance history of such advisor or pool is required in lieu of capsule performance data. To the extent that performance of principals is required, the revised rules require disclosure of the past performance of ''trading principals'' only.[74]

(i) *Performance of Major Commodity Trading Advisors: Rule 4.25(c)(3)*

For pools that do not have the three-year operating history specified in Rule 4.25(b), the revised rules require capsule format disclosure of CTA past performance only for ''major'' CTAs.

As discussed above,[75] the term ''major commodity trading advisor'' is defined in Rule 4.10(i) as a CTA allocated or intended to be allocated ten percent or more of the smaller of (i) the pool's aggregate net assets, or (ii) the aggregate value of the assets allocated to the pool's trading advisors, as determined based upon the agreement between the CPO and the CTA.

(ii) *Performance of Major Investee Pools: Rule 4.25(c)(4)*

The revised rules also require disclosure of past performance of investee pools constituting ''major investee pools,'' if the offered pool does not meet the standard of Rule 4.25(b). As discussed above,[76] Rule 4.10(d)(5) defines ''major investee pool'' as an investee pool allocated or intended to be allocated at least ten percent of the net asset value of a pool.[77] A commenter noted that the term ''investee pool'' was not defined in the former rules or in the proposed revisions. As noted above,[78] the Commission has adopted a definition of ''investee pool,'' set forth in Rule 4.10(d)(4), as ''any pool in which another pool or account participates or invests, *e.g.*, as a limited partner thereof.''

(iii) *CTAs and Investee Pools That Are Not ''Major'': Proposed Rules 4.25(a)(8) and 4.25(c)(3)(iii)*

The Commission had proposed in Rule 4.25(c)(3)(iii) to require that the CPO of an offered pool that does not satisfy the criteria of Rule 4.25(b) indicate any ''adverse performance'' (or, alternatively, provide a complete past performance capsule) with respect to those CTAs and investee pools allocated at least ten but less than twenty-five percent of the pool's assets (initial margins and premiums in the case of CTAs). Under proposed Rule 4.25(a)(8), ''adverse performance'' would have included: (i) Any annual rate of return that was at least one hundred basis points less than the ninety-day Treasury Bill rate on December 31 of the same

[70] If the pool or such persons did not have a prior trading history, indication of the lack thereof would have been required, using legends set forth in Rule 4.25(c).

[71] Proposed Rule 4.25(c)(3)(iii) would also have required that adverse performance be indicated for any account directed, or pool operated, by the CPO, and any trading principal of the CPO or trading manager (if any), unless such person's performance was otherwise required to be disclosed.

[72] The middle tier of the proposed three-tier disclosure scheme consisted of CTAs allocated at least ten, but less than twenty-five, percent of initial futures margin and option premiums, and investee pools allocated at least ten, but less than twenty-five, percent of pool assets.

[73] If the pool or such specified persons do not have a prior trading history, the lack thereof must be indicated by legends set forth in Rule 4.25(c), and discussed below in paragraph B.6. of this Section V.

[74] *See* Rule 4.25(c)(2), and Rule 4.10(e)(2) which defines the term ''trading principal,'' discussed above in Section IV. Former disclosure requirements mandated disclosures concerning *all* principals.

[75] *See* paragraph A. of Section IV.

[76] *See* paragraph B. of Section IV.

[77] The term ''pool'' continues to be defined in Rule 4.10(d)(1) as ''any investment trust, syndicate or similar form of enterprise operated for the purpose of trading commodity interests.''

[78] *See* paragraph B. of Section IV.

year; or (ii) the termination of a pool pursuant to a loss termination provision. Adverse performance would have been indicated by giving the year of occurrence, the rate of return, the identity of the CPO or CTA responsible, and that person's relationship to the offered pool.[79] The Commission sought comment with respect to the proposed definition of adverse performance, and in particular, as to whether any additional benchmarks would be appropriate for identifying what past performance was sufficiently ''adverse'' to warrant disclosure.

Numerous commenters strongly criticized both the adverse performance characterization and the concept of requiring specific disclosure of performance below a selected risk-free rate. In particular, several commenters objected to the adjective ''adverse'' as unnecessarily pejorative. Several commenters criticized the Treasury Bill benchmark as an inappropriate standard for a managed futures investment, and some commenters proposed alternative triggering events, such as a losing year, or a specified monthly or quarterly draw-down. Commenters asserted that CPOs would generally opt for including the full performance capsule rather than highlight negative results and, thus, that performance presentations would not in fact be streamlined by use of the adverse performance concept. Several commenters suggested a simplified, two-tier allocation standard for CTA and investee pool performance disclosure, with full disclosure for those above a specified percentage (between ten and twenty-five percent) and no performance disclosure for those with lesser allocations.

The Commission agrees with the proposition that material CTA or investee pool performance should be fully disclosed, and it believes that multiple standards can be confusing. Accordingly, the Commission is adopting a two-tier disclosure standard for an offered pool's CTAs and investee pools, rather than the three-level approach set forth in the Proposing Release. Under the adopted standard, full performance disclosure, *i.e.*, capsule performance data, is required with respect to CTAs and investee pools with allocations in excess of the designated benchmark, *i.e.*, ''major'' CTAs and investee pools. As adopted, the revised rules omit the proposed requirement to indicate adverse performance for CTAs and investee pools with allocations of at least ten percent, but less than twenty five percent.[80] Because this type of individual performance disclosure is being eliminated for non-major CTAs and investee pools, the Commission has determined to reduce the percentage allocation standard for major CTAs and investee pools from twenty-five to ten percent. As discussed more fully below, a narrative summary description is required for CTAs and investee pools with lesser allocations.

(iv) *Past Performance of CTAs and Investee Pools That Are Not Major: Rule 4.25(c)(5)*

As noted above, the Commission has adopted a simplified approach to the disclosure of past performance under which capsule performance data would be required for CTAs and investee pools with ten percent or greater allocations and no intermediate category of CTAs and investee funds would exist for which ''adverse performance'' would be disclosable. The Commission recognizes, however, that any simple quantitative standard such as the ten percent allocation standard can provide only a convenient point of reference to assure a minimum level of performance disclosure, but that pools may be structured, or their assets traded in such a manner, that use of the ten percent allocation standard will not be sufficient to identify all potentially relevant past performance data. Consequently, to supplement the required performance data for major CTAs and investee pools, the Commission is requiring in Rule 4.25(c)(5) a summary description of the performance history of non-major CTAs and investee pools, including monthly return parameters, *i.e.*, highest and lowest monthly rates of return, historical volatility information, an explanation of the degree of leverage used in the trading of such CTA or investee pool, and an identification of any material differences between the performance of such advisors and pools and that of the offered pool's major trading advisors and investee pools.

This requirement for summary performance disclosure of non-major CTAs and investee pools reflects the fact that the trading of pool assets may be distributed among multiple CTAs and investee funds, such that a substantial portion of the pool's assets, all of the pool's assets, or even a multiple of the pool's assets, may effectively be allocated to CTAs or investee pools which are not ''major'' and about whom performance data and other information may not generally be presented. Nonetheless, such advisors and investee pools collectively may determine the success or failure of the pool. It also reflects the fact that quantitative allocation figures alone may not be adequate to identify the extent of a particular advisor's or investee pool's impact upon the offered pool. For example, a CTA with a five percent allocation may have such an aggressive trading strategy that the impact of its trading results on the overall return of the pool may be greater than the impact of a trading advisor with an equivalent or larger allocation who follows a less aggressive trading strategy. Under Rule 4.25(c)(5), CPOs will be able to devise individualized approaches to conveying the historical volatility and other pertinent characteristics of the past performance of non-major CTAs and investee pools.

(v) *Updating Past Performance Information for Certain Persons: Proposed Rules 4.22(a)(4) and 4.26(c) for CPOs*[81]

The Commission proposed to add a new paragraph (a)(4) to Rule 4.22, which would have required the periodic Account Statement that a CPO must deliver to pool participants to include the names of all of the pool's CTAs and investee funds (including investee pools), together with the percentage of pool assets each is allocated, regardless of the amount of pool assets so allocated.[82] Rule 4.22(a)(4) would also have required that the Account Statement include past performance disclosure with respect to each new major CTA or major investee pool for whom past performance data was not previously provided in the Disclosure Document, *i.e.*, CTAs and investee funds previously allocated less than ten percent of the pool's futures margins or assets, respectively.

Commenters criticized the proposed inclusion of performance information in Account Statements as unreasonably expensive and burdensome. Some commenters contended that Account Statements are essentially financial statements subject to audit and should

[79] Unless their past performance was otherwise disclosed, Rule 4.25(c)(3)(iii) would also have required an indication of adverse performance with respect to accounts (including pools) traded by the CPO, the trading principals of the CPO (or trading manager), trading principals of major CTAs that had no prior trading history, and the trading principals of major investee pools that had no prior trading history.

[80] The requirement in proposed Rule 4.25(c)(3)(iii) to indicate adverse performance on the part of accounts (including pools) directed or operated by the offered pool's CPO, any trading principal of the CPO or any trading principal of the trading manager is also being eliminated.

[81] Because of the differences between CPOs and CTAs, CTAs have no corresponding requirements.

[82] Rule 4.22(b) states that the Account Statement must be distributed at least monthly in the case of pools with net assets of more than $500,000 at the beginning of the pool's fiscal year, and otherwise at least quarterly.

not include performance information. Still others argued that Account Statements should not be used to update or amend Disclosure Documents. Other commenters criticized the requirement to identify all CTAs and investee pools, while under proposed Rules 4.24 (e)(3) and (e)(4) only those allocated ten percent or more of pool assets would be required to be identified in the Disclosure Document.

The Commission notes that the proposed expansion of the data to be included in Account Statements was designed largely in response to concerns expressed by CPOs as to how to efficiently update Disclosure Documents to include new CTAs and in response to claims that disclosure of the names of investee funds was less onerous and more appropriate in communications with existing pool participants than in Disclosure Documents. Further, such CTA and investee pool information would not be required to be certified by the pool's accountants. Thus, as proposed, the rule would have provided a convenient mechanism for providing a complete, current picture of the pool's CTAs and investee pools.

Nonetheless, since the commenters appeared to find the proposed modifications of Rule 4.22 burdensome rather than helpful, the Commission has determined not to amend Rule 4.22. Instead, the existing updating requirements for Disclosure Documents will continue to apply, except as noted below with respect to the periodic update requirement. When a pool acquires a new major CTA or major investee pool, if such event is of material significance, the CPO will be required to notify pool participants and to provide the relevant information including performance records, as required by Rule 4.26(c),[83] within twenty-one calendar days after the CPO knows or should know of this occurrence. As was the case under the former rules, correction of Disclosure Documents may be accomplished by way of an amended Disclosure Document, Account Statement, a sticker on the Disclosure Document, or other similar means.

(vi) *Trading Managers: Rule 4.25(c)(2)*

The revised rules take into account arrangements in which a CPO delegates authority to a trading manager to select CTAs or investee pools to which the pool's assets will be allocated.[84] The term ''trading manager'' is defined in new Rule 4.10(h) as any person, other than the pool's CPO, with authority to allocate pool assets to CTAs or investee pools.[85] Rule 4.25(c)(2) requires trading manager performance in addition to CPO performance if the pool has a trading manager. In such cases, the trading manager is, in effect, a supervisory CTA and the performance of such manager is clearly material. As discussed *supra,* the requirement has been changed from an alternate one, *i.e.*, CPO or trading manager's performance, to include performance of both on the basis that even where a trading manager has been appointed, generally the CPO will continue to exercise ultimate control over the pool's operations. However, in cases where the trading manager has been given complete authority over the pool's trading and the performance of the trading manager does not differ materially from that of the pool operator, Rule 4.25(c)(2) provides that performance data for the pool operator may be omitted.

2. Required Past Performance Disclosure in CTA Disclosure Documents: Rule 4.35

Proposed Rule 4.34(a)(1) would have required CTAs to continue to present past performance of the offered trading program in the full multi-columnar format required by former Rule 4.31(a)(3). Most commenters strongly urged that CTAs be permitted to use the new capsule format. Some argued that if the offered trading program's performance must be presented in the multi-column format, the CTA will be forced to produce a separate Disclosure Document for each program he offers or to include all past performance in the multi-columnar format. One commenter suggested permitting use of the capsule format for the CTA's offered trading program but requiring monthly rates of return.

The Commission has determined to modify proposed Rule 4.34(a) to provide that the past performance of the CTA's offered trading program be presented in capsule format.[86] The capsule will include the names of the CTA and the trading program, the dates on which the CTA began trading client accounts and on which accounts were first traded pursuant to the trading program, the number of accounts traded pursuant to the trading program, and the total assets under management by the CTA and total assets traded pursuant to the trading program. The worst monthly and peak-to valley draw-downs experienced by the trading program are also required. Like the offered pool's performance in a CPO Disclosure Document, the capsule for a CTA's offered program is required to include monthly rates of return. The offered trading program's monthly rates of return may be presented either in a table or in a bar graph or chart. (Rule 4.35(a)(2) (ii) and (iii)). The offered program's capsule must also include the number of accounts closed with positive net performance during the most recent five calendar years and year-to-date, as well as the number of accounts closed with negative net performance during the same period. (Rule 4.35(a)(1)(viii)). CTAs will be required to provide prospective and existing clients, upon request, with the offered trading program's performance in the multi-column format previously required. (Rule 4.35(a)(2)(iv)).

The Commission believes that with the specified additional requirements for the offered trading program, this modification of the proposal will result in simplified CTA Disclosure Documents, while providing prospective clients with material information regarding trading program volatility.

3. Time Period for Which Required Past Performance Disclosures Must Be Made: Rules 4.25(a)(5) for CPOs and 4.35(a)(5) for CTAs[87]

Proposed Rules 4.25(a)(7) and 4.34(a)(4) would have extended the time period for which performance must be disclosed from three years to five years (or the life of the pool or account, if less than five years). As stated in the Proposing Release, the Commission believes that requiring performance to

[83] Rule 4.26(c), discussed below at paragraph B of Section VII, sets forth the requirements for amending pool Disclosure Documents to reflect a material change in the document. This requirement previously was found in former Rule 4.21(b).

[84] *See, e.g.,* Rule 4.25 (c)(2).

[85] As the Commission noted in the Proposing Release, the practice of retaining trading managers to select and monitor the performance of CTAs and investee pools to which pool assets will be committed has become commonplace. CPOs commonly seek to maximize pool returns by allocating pool assets based on analysis of the returns achieved by CTAs retained for the pool and investee pools in which the pool has invested in light of their aggregate results, market conditions, and the performance of other CTAs and investee pools. CPOs frequently rely on trading managers to continously review the performance of CTAs and investee pools and allocate and reallocate pool funds. Because of the importance of the trading manager and the fact that the trading manager is a CTA for the pool, when a pool has a trading manager, the trading manger's performance is generally required in addition to that of the CPO. 59 FR 25351, 25357.

[86] With respect to CTAs calculating rates of return on the basis permitted by Advisory 93–13, as discussed *supra*, the capsule must include rates of return for the fully-funded subset and Commission staff will provide guidance concerning supplemental data to accompany the capsule disclosure to reflect the range of levels of partial funding and the generic disclosures discussed in Advisory 93–13.

[87] Former Rules 4.21 (a)(4) and (a)(5) for CPOs and 4.31(a)(3) for CTAs generally required past performance to be presented for a three-year period.

be disclosed for a period longer than three years will make the timespan covered by performance disclosures more uniform and will better portray the evolution of performance over time, including positive and negative fluctuations in returns.[88] Two commenters supported the proposed five-year timeframe, noting that if all registrants may use the capsule format, investors will be provided with material information without increasing the volume of performance disclosure. One commenter, however, claimed that extending performance from three to five years would work against streamlining and reducing the volume of disclosure and would not enhance investor understanding.

The Commission is adopting Rules 4.25(a)(7) and 4.34(a)(4) as proposed (proposed Rule 4.34(a)(4) has been re-numbered Rule 4.35(a)(5), however). As noted in the Proposing Release, under the new summary format for performance disclosure, performance presentations are substantially condensed and multiple tables in the new summary format can be included on a single page. Consequently, adoption of a five-year disclosure period should not entail any significant increase in the volume of performance disclosures. The Commission believes that the benefits of this additional disclosure outweigh any minor resulting increase in the quantity of data disclosed.[89]

4. Composite Performance Presentations: Rules 4.25(a)(3) and (a)(4) for CPOs and Rule 4.35(a)(3) for CTAs[90]

As noted in the Proposing Release, the Commission has carefully considered the benefits and disadvantages that may accrue from the use of composites.[91] Thus, as proposed and as adopted, the new rules employ an approach designed to realize the benefits of reducing the volume of performance data created by the use of composites while minimizing the potential for misleading past performance presentations.

a. CPO Disclosure Documents

Proposed Rule 4.25(a)(3) would have required that past performance data for the offered pool and for pools similar to the offered pool be separately disclosed, on a pool-by-pool basis. (Rule 4.25(a)(3)(i)). Pools of a different type from the offered pool could be presented in composites with other pools of the same class, provided that such presentations were not misleading, that the manner in which the composite was developed was disclosed, and that the CPO was able to justify the inclusion of pools in a composite. (Rule 4.25(a)(3)(ii)). As proposed, Rule 4.25(a)(3)(iii) listed a non-exclusive set of five specific class distinctions requiring separate rather than composite presentation but recognized that additional factors might warrant creation of additional composite categories.[92] In addition, Rule 4.25(a)(3)(iv) would have required that material differences among the pools for which past performance is presented must be disclosed.

Numerous comments were received on proposed Rule 4.25(a)(3), several of which urged the adoption of three categories for composite performance presentation: guaranteed pools, non-guaranteed multi-advisor pools and non-guaranteed single-advisor pools.[93] Several commenters asserted that the distinction between public and privately offered pools can be eliminated by pro forma adjustments for cost differences. One commenter remarked that since virtually all pools use different trading programs, composite presentations might be precluded altogether under the proposed rule. Other commenters contended that some of the listed pool categories were too broadly worded. Still other commenters criticized use of the concept of specified pool classes for purposes of determining what pools may be combined in a single composite or the particular categories proposed by the Commission, suggesting either a general materiality standard for determining whether differences among pools require separate composites or inclusion in a single composite of all pools operated by the CPO and structured similarly to the offered pool. Some commenters contended that even pools similar to the offered pool should be included in one composite, instead of separately presented.[94] One commenter urged that CPOs not be under an obligation to be prepared to justify the inclusion of pools in a composite but, rather, that the CPO be permitted to exercise reasonable discretion in this matter.

The Commission specifically requested comment as to the costs and benefits of a general requirement of separate rather than composite presentations of pool performance in lieu of a qualified approach of the nature proposed. Commenters stated that greater use of composite presentations should be permitted, *e.g.*, composite presentation of performance for pools of the *same* class as the offered pool or inclusion of all of a CPO's prior pools in one composite.

Rule 4.25(a)(3) has been adopted as proposed with certain modifications. Pools with materially different rates of return may not be included in the same composite, regardless of class. (Rule 4.25(a)(3)(ii)(B)). The Commission believes that separate presentation of the performance of other pools of the same class as the offered pool provides useful information to the reader since such pools should provide the most comparable performance content and has thus retained this requirement. However, the Commission has simplified the criteria for determining what types of pools may be included in a composite capsule. The Commission has determined to delete two of the distinctions specified in proposed Rule 4.25(a)(3)(iii) (''pools using different leverages'' and ''pools using different trading programs''), on the ground that

[88] 59 FR 25351, 25358.

[89] As noted above, the NFA Special Committee for the Review of CPO/CTA Disclosure Issues suggested that the capsule include at least five years of performance history.

[90] Former Rule 4.21(a)(4)(iv) permitted the performance of pools operated by each person for whom performance was required to be disclosed to be presented on a composite basis, provided that the performance of the offered pool was separately disclosed, the CPO described how each composite was developed, and the composite was not misleading. Former Rule 4.31(a)(3)(iii) also permitted composite presentation of the performance of accounts directed by the CTA and each of its principals, provided that material differences among the accounts and the manner in which the composite was developed were described.

[91] 59 FR 25351, 25359. Specifically, the Commission noted that:

Composite presentations have the obvious advantage of reducing the volume of past performance data presented. However, composite presentations raise a number of regulatory concerns precisely because they supplant individualized presentations of potentially quite different types of pools and trading programs and may smooth or camouflage actual rates of return. Composite results not only fail to reflect differences among the pools and accounts whose results are presented but also merge potentially disparate trading results into average trading results and thus fail to reflect the actual dispersion of returns as well as the volatility of individual pools and accounts. *Id.*

[92] The distinctions set forth in proposed Rule 4.25(a)(3)(iii) are: Pools privately offered pursuant to Regulation D under the Securities Act of 1933 and publicly offered pools; pools using materially different leverages; pools using different trading programs; pools with a guarantee feature and pools without such a feature; and multi-advisor pools and non-multi-advisor pools. The CPO would have discretion to use additional criteria and would be required to do so where use of a composite would be misleading. *See* Rule 4.24(w), which requires disclosure of all material information.

[93] NFA's Submission had proposed the same three categories.

[94] One commenter suggested that performance of all pools other than the pool being offered should be presented in the second part of a two-part Disclosure Document. The Commission will take this comment into consideration in the course of its review of other issues raised by the bifrucated disclosure format.

they may be difficult to apply and thus may preclude the use of composites in most or all cases, and otherwise to adopt Rule 4.25(a)(3) essentially as proposed.[95] Two pools that use different trading programs or different degrees of leverage could therefore be included in the same composite, provided that material differences among the pools are disclosed and provided that such pools' rates of return are not materially different.

The Commission is retaining two of the remaining pool categories specified in proposed Rule 4.25(a)(3), *i.e.*, pools privately offered pursuant to the Securities Act[96] and public offerings; and principal-protected and non-principal-protected pools. With respect to the proposed differentiation between multi-advisor pools as defined in Rule 4.10(d)(2) and non-multi-advisor pools, the Commission is adopting a more flexible approach pursuant to which multi-advisor pools will be presumed to have rates of return that are materially different from those of non-multi-advisor pools and thus may not be included in the same composite, absent clear evidence to the contrary. The Commission believes that this qualified approach is warranted because multi-advisor pools will tend to have different fee structures and risk/reward profiles than non-multi-advisor pools, yet, in part due to the definitional complexity of the multi-advisor pool concept, this may not be true in all cases.

As adopted, Rule 4.25(a)(3) retains the proposed requirements regarding separate and composite performance presentations for the CPO's other pools. First, pools of the same class as the offered pool must be presented separately, following the offered pool's performance. Second, performance of any remaining pools must be presented less prominently, and may be presented in composites. Third, only pools belonging to the same class, and that do not differ materially from each other in their rates of return, may be included in the same composite. Finally, material differences among pools for which performance is presented must be disclosed. The Commission reiterates that the categories specified in Rule 4.25(a)(3)(iii) are illustrative and not exclusive.

In deciding not to permit general compositizing of the CPO's other pools that differ from the offered pool, the Commission notes that while composites condense voluminous material into digestible units, overly inclusive composites tend to flatten performance fluctuations and thus may obscure variations in rates of return and volatility among pools. Registrants therefore must use care in constructing composites, and material differences between and among pools (including the distinctions set forth in Rule 4.25(a)(3)(iii)) are ordinarily indications against composite presentation.[97]

As the Commission noted in the Proposing Release, there may be instances in which even composites of pools of the same class may be misleading, such as where differences between or among the trading results of the pools are so great that a composite would materially distort their results.[98] The express restriction against inclusion of pools with materially different rates of return in the same composite addresses this concern to some extent, but other types of differences, *e.g.*, different volatility levels, could be material. The proviso in Rule 4.25(a)(3)(ii) that results may be presented in composite form ''unless such presentation would be misleading'' is intended to ensure that composites are carefully reviewed to protect against any material distortion that may result from use of this format.

To present capsule performance of pools in a composite, the CPO must name all pools included in the composite, set forth the classes of these pools (which, as discussed above, would be the same for each pool in the composite), including at a minimum and, as applicable, the classes specified in Rule 4.25(a)(3)(iii) and specify the date on which each pool commenced trading. For composite capsule performance purposes, the aggregate gross capital subscriptions are the total subscriptions for all pools in the composite, the draw-down figures are the worst experienced by any one of the pools included in the composite and the rate of return is the weighted average rate of return for all pools included.

Proposed Rule 4.25(a)(4) would have required that the past performance of accounts be presented in capsule format on a program-by-program basis. As adopted, Rule 4.25(a)(4) permits program-by-program presentation unless such a presentation would be misleading. In addition, accounts with materially different rates of return may not be included in the same composite, and the CPO must discuss all material differences among accounts included in a composite.

b. CTA Disclosure Documents

Proposed Rule 4.34(a)(5) would have provided that the performance of accounts traded pursuant to the same trading program could be presented in the same composite, unless to do so would be misleading, provided that the CTA describes how the composite performance information was calculated. Under proposed Rule 4.34(a)(5), ''trading program'' would have been defined as a trading strategy differentiated from other trading strategies by commodity trading methodology, degree of risk or degree of leverage. Commenters stated that ''trading program'' was already defined in existing Rule 4.10(g)[99] and argued that the Commission's proposal would have conflicted with the existing rule.

In adopting Rule 4.34(a)(5), renumbered as Rule 4.35(a)(3), the Commission has revised the text to eliminate the proposed definition of trading program as a trading strategy differentiated from other such strategies by trading methodology, degree of risk or degree of leverage. Instead, Rule 4.35(a)(3), like the parallel provision for CPO Disclosure Documents, provides that unless such a presentation would be misleading, past performance of accounts may be presented in a composite form on a program-by-program basis and that accounts that differ materially with respect to rates of return may not be presented in the same composite. In determining which accounts may be included in a single composite, the factors set forth in the proposed rule, trading methodology, degree of risk and degree of leverage, are ones that should be taken into consideration. Like Rule 4.25(a)(4) for CPOs, Rule 4.35(a)(3) for CTAs contains a proviso that results may be presented in composite form ''unless such presentation would be misleading.'' Further, CTAs are cautioned that other material differences among accounts may make presentation in the same composite misleading. As with

[95] The text of Rule 4.25(a)(3)(iii) is affected by the change of the term ''limited risk pool'' to ''principal protected pool'' in Rule 4.10(d)93) and the changed definition of ''multi-advisor pool'' in Rule 4.10(d)(2).

[96] *See* Section 4(2) of the Securities Act and Regulation D thereunder, 17 CFR 230.501–230.508 (1994).

[97] Material differences among the pools for which past performance is disclosed must be described. (Rule 4.25(a)(3)(iv)).

[98] 59 FR 25351, 25359. For example, two multi-advisor pools with no guarantee feature using the same CTAs could show widely disparate results unless each CTA were allocated substantially the same portion of each pool's assets. Also, two single-advisor pools with different CTAs may achieve very different results.

[99] The term ''trading program'' continues to be defined in existing Rule 4.10(g) as ''the program pursuant to which a (CTA) (1) directs a client's commodity interest account, or (2) guides the client's commodity interest trading by means of a sytematic program that recommends specific transactions.''

composite presentations of pool performance, 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.

c. Substantiating Composite Presentations

Rules 4.25(a)(7) and 4.35(a)(6) require that records be maintained substantiating the performance data set forth in CPO and CTA Disclosure Documents, respectively, and documenting the underlying calculations, in accordance with Rule 1.31. Naturally, this requirement also applies with respect to composite presentations. Although not specified in Rule 4.25(a)(3)(ii), as adopted, a CPO must be prepared to justify the inclusion of a given pool's past performance results in a composite.

5. Order of Required Performance Disclosures: Rules 4.25(a)(2), (a)(3)(i) and (a)(3)(ii) for CPOs and 4.35(a)(1) and (a)(2) for CTAs [100]

Proposed Rule 4.25(a)(2) for CPO Disclosure Documents would have required that the performance of the offered pool be identified as such, presented separately, and included before any other performance information.[101] Thus, if presentation of past performance in addition to that of the offered pool was required because the offered pool did not have the requisite three-year operating history under Rule 4.25(b), the offered pool's performance must be presented separately from, and prior to, any such other required performance data.[102] Under proposed Rule 4.25(a)(3), performance data for pools of the same class as the offered pool would be presented on a pool-by-pool, non-composite basis, after the performance history of the offered pool. The performance histories of pools of a different class from the offered pool would be presented after, and less prominently than, the performance records of pools of the same class as the offered pool. Proposed Rule 4.25(a)(1)(i)(H) specified that required performance disclosure for pools other than the offered pool must provide annual and year-to-date rates of return.[103] Similarly, for CTAs, proposed Rules 4.34(a)(1) and (a)(2) would have required that the performance of the offered trading program be displayed first and the performance of all other programs after that presentation.

The Commission is adopting the required order of performance presentation specified in proposed Rules 4.25(a)(2), (a)(3)(i) and (a)(3)(ii) for CPOs and in proposed Rules 4.34(a)(1) and (a)(2) for CTAs. Registrants are reminded that disclosure of performance information not required by Commission rules, federal or state laws or regulations, self-regulatory agency rules or laws of non-United States jurisdictions is subject to the rules on supplemental information, *i.e.*, it may not be misleading and it must follow the entire presentation of required performance information (except that proprietary, hypothetical, extracted, pro forma [104] or simulated trading results must be placed at the end of the Disclosure Document).[105]

6. Required Performance Legends

a. Legends Relating to Lack of Trading Experience: Rules 4.25(c) for CPOs and 4.35(b) for CTAs [106]

The proposed rules would have continued to require the inclusion of prescribed legends in specific circumstances, alerting prospective pool participants and discretionary account clients to the lack of performance history on the part of specified persons. In the case of pool Disclosure Documents, the proposed rules would have required legends with respect to the absence of performance history, where applicable, on the part of the pool, the CPO (or trading manager) and its trading principals, major CTAs and major investee pools. In CTA Documents, such legends would be required, if applicable, on the part of the CTA and its trading principals. In the interest of simplification and readability, the Commission proposed substantial revisions of the legends required by the former rules, generally to shorten them and to sharpen their focus upon the matters most pertinent to investors.[107]

The Commission received several comments favoring the proposed shortening of the required legends. The revised legends in proposed Rules 4.25(c) and 4.34(b) are being adopted as proposed (with Rule 4.34(b) being renumbered as Rule 4.35(b)) to provide and highlight important information in a more concise and comprehensible manner.[108] Prescribed legends in pool Disclosure Documents apply only where the offered pool does not meet the trading history criteria of Rule 4.25(b).[109] The prescribed legends have been shortened by eliminating introductory language stating that disclosure of the referenced information is required by the Commission. This focuses attention upon the primary point to be conveyed, *e.g.*, the fact that the CPO and its principals have not previously operated any commodity pools. Thus, the legend relating to the lack of trading history of a pool now reads: ''THIS POOL HAS NOT COMMENCED TRADING AND DOES NOT HAVE ANY PERFORMANCE HISTORY.'' (Rule 4.25(c)(1)(ii)).[110] Similarly, the legend relating to the lack of experience of the CPO or trading manager and its trading principals now reads: ''NEITHER THIS POOL OPERATOR (TRADING MANAGER, if applicable) NOR ANY OF ITS TRADING PRINCIPALS HAS PREVIOUSLY OPERATED ANY OTHER POOLS OR TRADED ANY OTHER ACCOUNTS.'' (Rule 4.25(c)(2)(ii)). Similar legends are required, where applicable, with respect to major CTAs and investee pools.

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[100] The Commission's disclosure rules previously did not specifically address the order of required performance disclosures.

[101] Proposed Rule 4.25(a)(2) also required that the offered pool's rate of return be stated in monthly increments.

[102] As discussed above, Rule 4.25(b) provides that if the offered pool has traded commodity interests for at least three years, during which time at least 75% of its assets were contributed by persons unaffiliated with its CPO, trading manager, CTAs or any of their principals, only the offered pool's past performance must be disclosed.

[103] As discussed above, Rules 4.25(a)(3) and (a)(4) provide guidance for determining whether pools or accounts may be included in the same composite.

[104] As discussed in Section V.C.3. *infra,* pro forma adjustments to performance data are required for certain purposes and such adjustments are not affected by the restrictions upon placement of supplemental information.

[105] Rules 4.24(v) for CPOs and 4.34(n) for CTAs (both captioned ''Supplemental information''), are discussed more fully below in Section VI.

[106] Former Rules 4.21(a)(4) and (a)(5) for CPOs and 4.31(a)(3) for CTAs required lengthier legends. For example, former Rule 4.21(4)(i)(B) specified a statement that the Commission requires disclosure of the performance of the offered pool and of other pools operated by the CPO and its principals and that neither the CPO nor its principals have any prior performance history. *See* 59 FR 25351, 25361 for a more complete discussion of the former requirements.

[107] 59 FR 25351, 25361.

[108] The Commission is retaining in Rules 4.25(c) and 4.35(b) the explanation that if any of the persons for whom a prescribed legend must be displayed is a sole proprietorship, reference to its trading principals need not be included.

[109] Those criteria, as adopted, are: (1) The pool has traded commodity interests for at least three years; and (2) during the three-year (or greater) period, at least seventy-five percent of the pool's assets were contributed by persons unaffiliated with the CPO, the trading manager (if applicable), the CTA or any of their principals.

[110] The legend required by former Rule 4.21(a)(4)(c) read as follows:

THE COMMODITY FUTURES TRADING COMMISSION REQUIRES A COMMODITY POOL OPERATOR TO DISCLOSE TO PROSPECTIVE POOL PARTICIPANTS THE ACTUAL PERFORMANCE RECORD OF THE POOL FOR WHICH THE OPERATOR IS SOLICITING PARTICIPANTS. YOU SHOULD NOTE THAT THIS POOL HAS NOT BEGUN TRADING AND DOES NOT HAVE ANY PERFORMANCE HISTORY.

(Rules 4.25(c)(3)(ii) and (c)(4)(ii), respectively). The revised rules similarly require a CTA Disclosure Document to disclose, if applicable, the lack of experience of the CTA and its principals. If the CTA has no prior experience, the following legend is to be included: ''THIS TRADING ADVISOR PREVIOUSLY HAS NOT DIRECTED ANY ACCOUNTS.'' (Rule 4.35(b)(1)). The following legend is to be used for trading principals: ''NONE OF THE TRADING PRINCIPALS OF THIS TRADING ADVISOR HAS PREVIOUSLY DIRECTED ANY ACCOUNTS.'' (Rule 4.35(b)(2)). If neither the CTA nor any of its principals has prior trading experience, rather than displaying two separate cautionary legends concerning the CTA and the CTA's principals, the following single sentence is to be included: ''NEITHER THIS TRADING ADVISOR NOR ITS TRADING PRINCIPALS HAVE PREVIOUSLY DIRECTED ANY ACCOUNTS.'' (Rule 4.35(b)(3)).

b. Legends Relating to Predictive Value of Past Performance: Rules 4.25(a)(9) for CPOs and 4.35(a)(8) for CTAs [111]

To indicate the general lack of predictive value of past performance information, proposed Rules 4.25(a)(10) for CPOs and 4.34(a)(7) for CTAs would have required that any past performance information, whether required or voluntarily provided, be preceded by the statement that ''PAST PERFORMANCE IS NOT PREDICTIVE OF FUTURE PERFORMANCE,'' prominently displayed.[112] Thus, if a registrant presents both required and voluntarily provided performance information in its Disclosure Document, the specified disclaimer must precede each such performance presentation.

One commenter strongly opposed the proposal as a ''potentially misleading'' departure from the language of NFA Compliance Rule 2–29, which prohibits reference to past trading profits without mentioning that past results ''are not necessarily indicative of future results.'' [113] Other commenters stated, similarly, that ''not necessarily indicative'' is more accurate and balanced than ''not predictive.''

Although the Commission does not agree that the proposed legend was either potentially misleading or less accurate than NFA's existing performance disclaimer, it has determined to revise the proposed text of this legend in the interest of establishing a single, uniform standard. Consequently, the Commission has revised the text of the proposed legend to conform it to the language of NFA Compliance Rule 2–29, that is, ''Past performance is not necessarily indicative of future results.'' [114] However, the Commission may revisit this issue in the context of its further consideration of past performance and risk disclosure issues. The Commission believes that pools are likely to be sold based on past performance claims and therefore, a formatted disclosure requirement assures consistency and auditability. The Commission remains convinced that past performance is not generally predictive of future rates of return.

7. Summary Tables

a. Performance Disclosure Requirements

The following table summarizes the past performance requirements set forth in Rules 4.25 and 4.35.

SUMMARY OF REQUIRED PERFORMANCE DISCLOSURES—CPO DISCLOSURE DOCUMENTS

Category	Requirement
Offered pools with 3 years history & 75% or more of assets from non-affiliates of CPO, trading mgr., CTAs or principals.	—Performance of offered pool for five most recent calendar years and year-to-date (''YTD'') (or if shorter, for life of pool), with monthly rates of return (''RORs'') presented in bar graph or table. Rules 4.25(b); 4.25(a)(5); 4.25(a)(2).
Offered pools that do not meet three-year history and asset contribution standards.	—Performance of offered pool for life of pool first, with monthly RORs in table or bar chart. Prescribed statement if pool has no operating history. Rules 4.25(c)(1); 4.25(a)(2). —Performance of CPO's and trading manager's other pools and accounts for five most recent calendar years and YTD, with annual RORs. Performance for pools of the same class as the offered pool must be presented more prominently than that of other pools. Rule 4.25(c)(2)(i). —If CPO or trading manager has less than three-year history in trading pools with 75% outside contributions, performance of CPO's trading principals, with annual RORs. Prescribed statement if no prior trading history of CPO/trading manager or trading principals. Rules 4.25(c)(2)(i); 4.25(c)(2)(ii). —Performance of major CTAs and investee pools. Prescribed statement if no prior history. Rules 4.25(c)(3), 4.25(c)(4). —Narrative description of non-major CTAs' and/or investee pools' past performance, trading, investment activities, strategies, and experience. Rule 4.25(c)(5).
All	—Required performance is to be given for most recent five calendar years and YTD (or, if shorter, for life of account). Rule 4.35(a)(5). —Performance of offered trading program presented first, with monthly rates of return presented in bar graph or table. CTA must make performance available in multi-column format of former Rule 4.21(a)(5) upon request. Rule 4.35(a)(2). —Performance of each other account directed by CTA and by each of CTA's trading principals, with annual RORs. Rule 4.35(b). —Performance of accounts traded pursuant to same trading program may be presented in composite unless misleading. Rule 4.35(a)(3). —Prescribed statement if no prior trading history of CTA or trading principals. Rule 4.35(b).

[111] The Commission's former disclosure rules did not contain any such legends with respect to past performance generally. Rule 4.41(b) specifies a disclaimer required to precede the presentation of simulated or hypothetical performance results, and NFA Compliance Rule 2–29(b)(5) requires language similar to that in proposed Rules 4.25(a)(10) and 4.34(a)(7).

[112] As the Commission noted in its proposal, numerous studies have shown the general lack of predictive value of past performance. 59 FR 25351, 25361 at n.42.

[113] NFA Compliance Rule 2–29, which concerns communications with the public and use of promotional materials by NFA members, prohibits a member or associate from using promotional material which ''includes any reference to actual past trading profits without mentioning that past results are not necessarily indicative of future results.'' (NFA Compliance Rule 2–29(b)(5)).

[114] The Commission is adopting proposed Rules 4.25(a)(10) and 4.34(a)(7) as Rules 4.25(a)(9) and 4.35(a)(8), respectively.

b. Sample Capsule Performance Presentations

The following are examples of ''capsule'' performance presentation under Rules 4.25 and 4.35.

CAPSULE PERFORMANCE EXAMPLES UNDER RULE 4.25 CAPSULE PERFORMANCE OF THE OFFERED POOL

[XYZ Partners, L.P. is a privately offered, single-advisor pool that does not have a guarantee feature. Past performance is shown for the most recent five calendar years and year-to-date (monthly rates of return for the most recent calendar year and year-to-date). For purposes of this example, it is assumed that thirty percent of the assets were provided by X, the CPO, and that the performance of other pools operated by X is therefore required to be presented. Of the other pools operated by X, Pool A, which is of the same class as the offered pool is presented first (and separately). Pools B, C and D are of different classes than that of the offered pool, and since Pools B and C belong to the same class, the performance of B and C is presented in a composite.]

Percentage rate of return (computed on a compounded monthly basis)	Month					
	Year-to-date	1994	1993	1992	1991	1990
January	1.12	2.43	3.50	2.56	1.54	0.69
February	1.34	3.11	(2.30)	1.96	(0.89)	(0.82)
March	0.96	(0.23)	1.60	3.72	1.15	0.55
April	1.45	1.16	1.22	4.66	0.97	1.06
May	.....	1.54	(3.62)	2.75	1.21	0.90
June	.....	0.32	1.32	(16.87)	0.51	1.12
July	.....	1.28	1.15	(9.87)	0.11	1.01
August	.....	1.12	1.85	(7.03)	(0.14)	0.93
September	.....	2.09	0.87	5.61	0.56	0.99
October	.....	1.34	2.10	4.23	0.23	1.01
November	.....	1.57	0.90	3.97	1.11	1.19
December	.....	1.04	0.825	3.81	0.32	1.14
Year	6.32	18.66	8.48	(3.60)	7.80	12.11

Offered pool
Name of Pool: XYZ Partners, L.P.
Type of Pool: Privately offered
Inception of Trading: January 1, 1989
Aggregate Subscriptions: $1,673,000
Current Net Asset Value: $1,925,000
Worst Monthly Percentage Draw-down:* 7–92/16.54%
Worst Peak-to-Valley Draw-down: 6 to 9–92/30.52%
*''Draw-down'' means losses experienced by the pool over a specified period.

CAPSULE PERFORMANCE OF OTHER POOLS OPERATED BY THE OFFERED POOL'S CPO

Name of pool	Type of pool	Inception of trading	Aggregate subscription ($ × 1,000)	Current total NAV ($ × 1,000)	Worst monthly percent draw-down	Worst peak-to valley draw-down	Percentage rate of return (computed on a compounded monthly basis)					
							1990	1991	1992	1993	1994	Year-to-date
Other pools operated by X, different class from offered pool:												
A	2	8/86	617	730	(11.73) 7/93	(19.61%) 4–8/91	11.17	6.2	3.4	10.6	6.8	6.82
Other pools operated by X, same class as offered pool:												
B; C	2, 3	8/93; 10/89	9,101	20,701	(1.09) 12/93*	(1.09%) 10–12/93*	6.8	8.9	9.6	11.2	12.6	0.51
D	1, 2	1/90	931	379	(16.01) 6/92	(40.81%) 5–8/92	(2.3)	4.3	6.2	(8.2)	13.9	(17.26%)

Key to type of pool
1—Principal-protected pool
1—Privately offered pool
3—Multi-advisor pool
*Worst draw-down for any of the pools included in the composite.
**In the case of composite presentation, combined rate of return figures are weighted on the basis of the net asset values of the pools included in the composite.

c. Sample Bar Chart/Graph of Monthly Rates of Return

The following is an example of monthly rates of return for a five-year period presented in the form of a bar chart.

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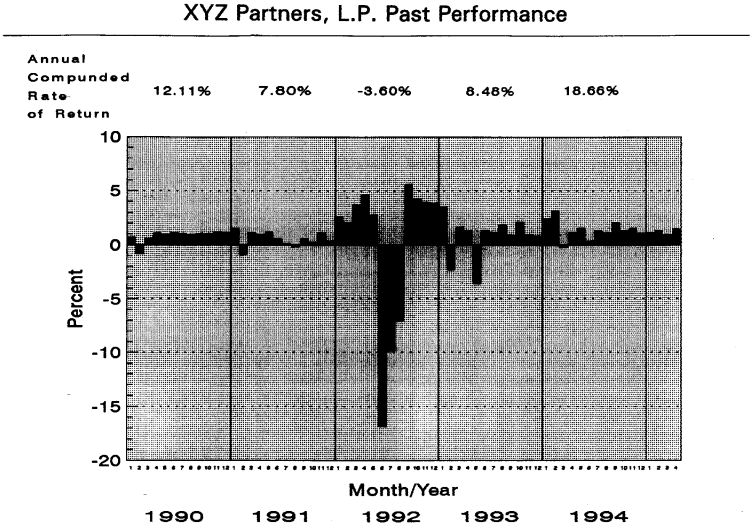

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C. Non-Required Performance Disclosures

1. Voluntary and Supplemental Performance Disclosures: Rules 4.24(v) for CPOs and 4.34(n) for CTAs [115]

Proposed Rules 4.24(v) and 4.33(n) would have required that information (including performance information) other than that required by Commission rules, the antifraud provisions of the Act,[116] or federal or state securities laws and regulations ''appear following the related required disclosures.'' In addition, the proposed rules provided that such information could not be misleading in content or presentation nor inconsistent with required disclosures. The purpose of these rules was to ensure that the principal focus of the Disclosure Document would remain upon the required information because of its generally high degree of materiality.

As emphasized in the Proposing Release, voluntary performance disclosures can readily be constructed to create misleading effects by, for example, focusing attention upon positive performance while omitting negative results. If the performance of two pools (other than the offered pool) operated by a CPO were voluntarily provided, it could be misleading to show the favorable performance of Pool 1 but not the negative performance of Pool 2 or to show the performance of Pool 1 in capsule format and that of Pool 2 in full format. It could also be misleading to show the performance of a pool in capsule format for year one and in full format for year two or to show the pool's performance for 1991 and not 1992. Clearly, care must be taken to assure that supplementally provided performance disclosures are not presented in a manner that creates the potential to mislead.[117]

Commenters claimed that in view of the requirement to disclose all material information,[118] the determination that information is not required by Commission rules, the Act or other laws necessarily involves a determination that the information is not material and that designating it as ''voluntary'' reinforces that determination. A number of commenters stressed the difficulty of determining in many cases what information is required to be disclosed and what is merely advisable, and believed that, in consequence, mandating that non-required information follow required disclosures could create confusion. Further, some commenters incorrectly read proposed Rules 4.24(v) and 4.33(n) to require placing all non-required information at the end of the document (instead of following the related required disclosures). One commenter suggested that placement of non-required information adjacent to the required information to which it relates may be clearer to the reader.

One commenter urged that CPOs and CTAs be permitted to present performance disclosure beyond the required five-year period, provided material changes are disclosed, while another commenter urged that CPOs and CTAs be required to present either five years' performance or the full trading history of the pool or trading program, in order to prevent ''cherry picking.''

As adopted, Rules 4.24(v) and 4.34(n) provide significantly more guidance regarding the placement of supplementally provided information. Rules 4.24(v) and 4.34(n), as adopted, also expand the category of required information to include information required by ''any applicable laws of non-United States jurisdictions.'' In addition, applicable federal and state requirements are no longer restricted to securities laws and regulations. The comments received and the Commission's action with respect to the application of proposed Rules 4.24(v) and 4.33(n) to supplementally provided non-performance information are discussed below in Section VI. With respect to supplemental past performance, however, the Commission believes that requiring such data to follow required past performance disclosure is appropriate.

The Commission will permit presentation of additional past performance information beyond the required five calendar years and year-to-date, provided that any such supplemental information is calculated in compliance with the requirements of

[115] Rules 4.24(v) and 4.34(n) regulate placement of *all* supplementally supplied information. Application of these rules to non-performance disclosures is discussed below at paragraph C of Section VI. The Commission's former disclosure rules did not specifically address the placement of voluntary performance disclosures.

[116] *See* Sections 4b and 4*o* of the Act, 7 U.S.C. 6b and 6*o* (1994). Section 4b of the Act prohibits fraud in connection with the making of any contract of sale of any commodity for future delivery. Section 4*o* of the Act prohibits CPOs, CTAs and their associated persons from employing any device, scheme, or artifice to defraud a pool participant, prospective pool participant or client and from engaging in any transaction, practice or course of business which operates as a fraud or deceit upon such participant or client. In addition, under section 4*o*(2) of the Act CPOs, CTAs and their associated persons are precluded from representing or implying that they have been sponsored, recommended or approved by the United States or by any agency or officer thereof.

[117] 59 FR 25351, 25361.

[118] Former Rules 4.21(h) and 4.31(g), renumbered as Rules 4.24(w) and 4.34(o).

Rules 4.25 or 4.35, as applicable, and is presented following all required performance disclosures. Such additional performance information must not be misleading. For example, if additional performance information beyond the required five years is presented but the entire history of the pool or program is not covered, the additional performance results shown must be representative of the results that would have been shown if the entire history were presented. Thus, ''cherry picking'' of performance data to highlight positive performance is a misleading practice precluded under existing antifraud standards. Generally, inclusion of voluntarily provided performance data should be made on a result-neutral basis that results in inclusion of all similar data.[119] The Commission also notes that the practice of advertising a pool by touting the excellent past performance record of a particular CTA to attract prospective participants and shortly thereafter reallocating pool assets to another CTA, a practice commonly referred to as ''bait-and-switch,'' is misleading and that use of performance data in this manner would violate relevant antifraud provisions.

Any proprietary performance must be presented in accordance with Rule 4.25(a)(8) for CPOs and Rule 4.35(a)(7) for CTAs, as discussed below. Hypothetical, extracted, simulated and pro forma[120] performance information is also now required by Rules 4.4(v) and 4.34(n) to be presented separately after all other information.[121]

2. Proprietary Trading Results: Rules 4.25(a)(8) for CPOs and 4.35(a)(7) for CTAs[122]

Proposed Rules 4.25(a)(9) and 4.34(a)(6) would have permitted CPOs and CTAs, respectively, to disclose proprietary trading results under appropriate restrictions. Proposed Rule 4.25(a)(9) would have provided that the performance of pools and accounts in which the CPO, trading manager, CTA or other person providing services to the pool owns or controls fifty percent or more of the beneficial interest may not be included in pool Disclosure Documents unless prominently labeled as proprietary and set forth separately following all required performance and non-performance disclosures. Proposed Rule 4.34(a)(6) set forth similar restrictions for CTA Disclosure Documents with respect to accounts in which the CTA or any of its principals or any person providing services to the account owns or controls fifty percent or more of the beneficial interests.

While a number of commenters agreed with the intent of the Commission's proposal, *i.e.*, to prevent disguising of proprietary trading by including an insignificant amount of money from ''outside'' participants, other commenters claimed that the proposal would have the undesirable effect of discouraging CPOs from investing in their own pools. One commenter stressed that proprietary trading is often the only way a pool can begin trading before raising outside capital. Commenters suggested raising the threshold for ownership or control by the pool operator, advisor, principals or other service providers from fifty to between sixty and eighty percent. Commenters also asked the Commission to clarify that the interests in the pool of the CPO, the CTA, their principals and other service providers are not required to be added together when applying the fifty percent test in proposed Rule 4.25(a)(9) unless such persons are affiliated. One commenter urged that the definition of proprietary performance should be broadened to include both accounts for which the CPO, trading manager, CTA or respective principals receive no direct fees, as well as pools in which an affiliate or family member of the CPO, trading manager or CTA owns or controls fifty percent or more of the beneficial interest. Several commenters suggested that if proprietary accounts are traded in a manner similar to pool and customer accounts, the rules should permit CPOs and CTAs to include the performance in a composite with customer accounts, provided *pro forma* adjustments are made for fees and other differences.

The Commission is adopting Rule 4.25(a)(9) (renumbered as Rule 4.25(a)(8)) and Rule 4.34(a)(6) (renumbered as Rule 4.35(a)(7)) substantially as proposed, permitting presentation of proprietary performance information, subject to restrictions intended to assure that the disclosure of such information is not misleading. Further, the Commission has determined to adopt the comment that accounts in which an affiliate or family member of the CPO, trading manager or CTA owns or controls fifty percent of more of the beneficial interest should be characterized as proprietary and has revised the rules accordingly. As adopted, the text of these rules has been reorganized for clarity and cross-references to the respective rule provisions governing placement of supplemental information have been included. The word ''required'' has been omitted to clarify the requirement that proprietary trading results (together with any hypothetical, extracted, pro forma[123] or simulated results) follow all of the other disclosures in a Disclosure Document.

Although proprietary performance results in CPO and CTA Disclosure Documents have a significant potential to mislead, given the often material differences in the conditions under which proprietary trading results as opposed to non-proprietary results are obtained, the Commission recognizes that proprietary trading results may be the only performance results available to some new traders to present to customers as evidence of trading experience.[124] The requirement that proprietary trading results be presented after all required and non-required disclosures, rather than just the required performance disclosures, reflects the relatively low utility of such data to prospective customers and the relatively high potential for confusion of proprietary and customer trading results. Given the significant potential

[119] Thus, for example, and as the Commission explained in the Proposing Release, in the case of a pool meeting the criteria of Rule 4.25(b), where only the past performance of the offered pool is required, the past performance of two CTAs each allocated an equal portion of the pool's assets generally should either be included for both CTAs or omitted entirely. Similarly, where only the past performance of the offered pool is required, generally the past performance of the CPO's other pools should be shown in total or omitted. *Id.*

[120] As discussed in section 3, *infra*, pro forma adjustments to performance data are required for certain purposes and such adjustments are not affected by the restrictions upon placement of supplemental information.

[121] If a Disclosure Document contains two or more of these types of performance information, the registrant may choose the order of presentation between or among them at the end of the document.

[122] The Commission's former disclosure rules did not specifically address the placement of proprietary trading results.

[123] *See* discussion in Section 3, *infra*, concerning required pro forma adjustments.

[124] As the Commission explained in its proposal,

> Use of proprietary trading results in soliciting customer accounts is a practice which has long been of concern to the Commission. CPOs and CTAs may trade proprietary funds for a variety of purposes, including to test a new trading strategy before implementing it for customer funds or to establish a track record prior to trading customer funds. However, proprietary accounts may be traded in a different manner, for example, more aggressively, using higher leverage and assuming greater risk, than customer accounts. Also, proprietary accounts are usually not subject to the same fee schedule as customer accounts. Naturally, no management or incentive fee would apply where a CTA traded its own account, and clearing fees may be waived or reduced if the account is cleared by an affiliate. In addition, where proprietary and customer assets are combined for purposes of performance presentations, the total amount of assets under management is inflated and conceals the actual amount of customer funds being traded. For these reasons, proprietary trading results may, in many cases, be of little relevance to a prospective pool participant or CTA client and actually misleading in others. 59 FR 25351, 25360.

to mislead inherent in proprietary trading results, the Commission believes that if such data are permitted to be included in the Disclosure Document, they should be placed after all required information in order to minimize the likelihood that such results will be accorded undue weight.

The Commission noted in the Proposing Release that staff have previously advised registrants that any proprietary trading results presented in a Disclosure Document must be clearly labeled as such and presented in a separate table.[125] Staff have also required that if fees, expenses, commissions, margin-to-equity ratios, or any other item pertaining to the proprietary trading is materially different from that relevant to the pool or trading program offered to participants or clients the registrant must ''pro forma'' such items to correspond to those in the pool or program being offered.[126] The Commission will continue to require registrants to make such pro-forma adjustments to proprietary trading results.

With respect to whether the interests of the CPO, the CTA, their principals and other service providers would be required to be aggregated for purposes of applying the fifty-percent test, the Commission generally agrees that the interests of unaffiliated parties need not be aggregated. However, a CPO would be considered to be affiliated with the CPO's principal, affiliates or family members, for example, and a CTA with its principals, affiliates or family members for this purpose.

3. Pro Forma, Hypothetical and Extracted Performance Results [127]

In the Proposing Release, the Commission discussed the potential for inappropriate use of certain types of performance data, specifically, hypothetical, pro forma and extracted results.[128] Hypothetical results are based on hindsight and can be readily manipulated. Pro forma results can reflect the same type of hindsight selection as hypothetical results and are thus also subject to abuse. Similarly, although extracted results are taken from actual results, they are subject to manipulation through, for example, emphasis upon results of an isolated portion of an overall trading strategy. Under the proposed rules, hypothetical, pro forma and extracted results would be treated like other disclosures voluntarily provided (proposed Rules 4.24(v) and 4.33(n)) and would be subject to the Commission's general antifraud provisions and such restrictions as may be imposed under the rules of a registered futures association. Further, of course, Rule 4.41 requires that any presentation of simulated or hypothetical trading results must be accompanied by a prescribed cautionary statement describing the limited value of such results.[129] As discussed *infra*, the Commission is amending Rule 4.41 to provide that such presentations must be accompanied either by the statement set forth therein or a statement provided for this purpose by a registered futures association.

In some circumstances, the Commission requires registrants to make pro forma adjustments to disclosed information, *e.g.*, to adjust performance presentations to the same fee structure as that of the pool or program being offered. Such pro forma adjustments are not within the scope of the restrictions of Rules 4.24(v) and 4.34(n). As noted in the Proposing Release, NFA has recently adopted Compliance Rule 2–29(c) which, together with an accompanying interpretive notice, requires that promotional materials containing hypothetical results include a prominently displayed prescribed disclaimer, comparable actual performance results displayed at least as prominently as hypothetical results, and a description of the material assumptions used, and that no statement be made placing undue emphasis on the hypothetical results.[130] The restrictions in NFA Compliance Rule 2–29(c) do not apply to promotional materials directed exclusively to ''qualified eligible participants'' as defined in Commission Rule 4.7(a)(1)(ii). However, Rule 4.41 requires that such a statement be provided without regard to the status of the offeree and will thus require that either the statement specified in Rule 4.41 or the statement specified in NFA Compliance Rule 2–29(c), if approved by the Commission, be provided whenever simulated or hypothetical trading results are presented.

Commenters generally agreed that hypothetical, pro forma, extracted (and simulated) results should not be prohibited, but should be subject to strict regulatory oversight and controls. The Commission was also urged to delegate to NFA and industry groups any rulemaking regarding use of pro forma, hypothetical and simulated results.

Based upon its review of the comments received and of NFA Compliance Rule 2–29(c) and the accompanying interpretive release, the Commission has determined to retain the same general approach to pro forma, hypothetical and extracted results as indicated in the Proposing Release, pending further review of this area. Although such results would not be precluded from inclusion in the Disclosure Document, Rule 4.24(v)(2)(iii) requires that such results, if included, must appear as the last disclosure in the document following all required and non-required disclosures. Further, such disclosures would be required to be accompanied by the cautionary language of Rule 4.41 or of NFA Compliance Rule 2–29(c), if approved by the Commission, with respect to the limited usefulness of hypothetical results, where applicable. To avoid duplication of cautionary statements as to the limitations of pro forma, hypothetical and extracted results, the Commission is adopting an amendment to Rule 4.41 to permit use of an NFA disclaimer in lieu of the disclaimer in Rule 4.41.

Like other supplemental disclosures, disclosure of pro forma, hypothetical and extracted results must comply with Rule 4.24(v) for CPOs and Rule 4.34(n) for CTAs. Moreover, such disclosures

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[125] 59 FR 25351, 25360.

[126] *Id. See* discussion in Section 3, *infra*, concerning required pro forma adjustments.

[127] Hypothetical results are results calculated based upon the application of a given program to historical market prices and purport to present results that could have been obtained in trading a particular program during the specified historical period. Pro forma results present trading results with adjustments to reflect certain factors, such as a particular fee schedule or degree of leverage, to permit easier comparison with other types of results. Extracted performance results isolate a single component of a trading strategy for presentation to customers. The Commission's former disclosure rules did not specifically address the placement of such performance results.

[128] 59 FR 25351, 25360.

[129] The statement required by Rule 4.41(b)(1) reads as follows:

''Hypothetical or simulated performance results have certain inherent limitations. Unlike an actual performance record, simulated results do not represent actual trading. Also, since the trades have not actually been executed, the results may have under-or-over compensated for the impact, if any, of certain market factors, such as lack of liquidity. Simulated 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 those shown.''

[130] 59 FR 25351, 25360. The draft Interpretive Notice accompanying NFA's proposed amendments to Compliance Rule 2–29 would permit pro forma performance histories solely for the purpose of adjusting performance presentations to the same fee structure as that of the pool or program offered. No pro forma results which reflect a hindsight analysis, such as to show results a multi-advisor pool could have achieved using a different allocation of assets among CTAs, would be permitted. Extracted results would only be permitted to be presented based on the percentage of net asset value actually committed to the particular component extracted.

must comply with applicable NFA restrictions and they are subject to the antifraud provisions of the Act and Commission rules.

VI. Non-Performance Disclosures: Section-by-Section Analysis

A. Introduction

As proposed and as adopted, non-performance disclosure requirements are now set forth in Rules 4.24 for CPOs and 4.34 for CTAs.[131]

Preliminarily, the Commission notes that it did not receive any comments on certain of its proposed non-performance disclosure requirements and is adopting those requirements as proposed. Specifically, these are the CPO requirements found in the following paragraphs of Rule 4.24: (n) (specified performance); (p) (transferability and redemption); (q) (liability of pool participants); (r) (distribution of profits and taxation); (t) (ownership in pool);[132] (u) (reporting to participants); and (w) (material information). For CTAs, corresponding requirements are found in the following paragraphs of Rule 4.34: (h) (description of trading program); (i) (fees); (m) (specified performance disclosures); and (*o*) (material information).

1. Disclosures Concerning a Pool's CTAs

As proposed, several provisions of Rule 4.24 would have based the level of required non-performance disclosures with respect to a pool's CTAs (and their principals) on such CTAs' respective percentage allocations of the pool's aggregate initial futures margin and premiums for commodity option contracts.[133] Several commenters recommended that these disclosure requirements (as well as the major CTA and multi-advisor pool definitions) be based upon the percentage of the pool's assets allocated to each CTA. As discussed above, the definition of major commodity trading advisor, as adopted in Rule 4.10(i), no longer is based upon the percentage of initial margin and premiums but, instead, considers the CTA's allocated portion of the pool's funds available for futures and option transactions pursuant to agreement between the pool's CPO or trading manager, on behalf of the pool, and the CTA. Wherever Rule 4.24, as proposed, keyed disclosure requirements regarding a pool's CTAs to allocation size, the rule as adopted uses the major CTA definition adopted in Rule 4.10(i).

2. Disclosures Concerning Investee Pools[134]

Unlike the former rules, the new disclosure framework (as proposed and as adopted) specifically addresses disclosures concerning investee pools. As with performance disclosure requirements, non-performance disclosure requirements relating to investee pools are also being tailored to take into account the relative importance of the investee pool to the offered pool, as measured by the amount of assets allocated or intended to be allocated to the investee pool. Thus, no disclosures would have been required for investee pools allocated or intended to be allocated less than ten percent of the assets of the offered pool. With respect to each investee pool allocated at least ten percent of the assets of the offered pool, the CPO would have been required to disclose the name of the operator and the operator's principals[135] and any conflicts of interest on the part of the investee pool's operator in respect of the offered pool.[136]

With respect to investee pools allocated twenty-five percent or more of the assets of the offered pool,[137] the CPO would have been required to disclose the business background of, material litigation against, and any ownership in the offered pool on the part of the investee pool's operator and the operator's principals. (Rules 4.24 (f), (*l*) and (t)). In addition, the proposed rules requiring disclosure of the use of proceeds (Rule 4.24(h)), risk factors (Rule 4.24(g)), fees and expenses (Rule 4.24(i)), and redemption restrictions (Rule 4.24(p)) would have required information relative to the offered pool's investments, including participation in investee pools. As the Commission explained in the Proposing Release, these provisions are appropriate because investments in investee pools may entail both the risks inherent in the investee pool's own investments and liquidity risks due to restrictions upon redemption of the investment in the investee pool; fees and expenses may accrue at each level of a multi-tier structure; and investments in investee pools with redemption periods different from those of the pool offered or with minimum ''lock-in'' provisions[138] may affect the ability of the top tier pool promptly to honor redemption requests from its participants.[139]

The Commission sought comment concerning the proposed treatment of investee pools. In particular, commenters were invited to address any special public policy or disclosure considerations presented by tiered investment structures by means of which a commodity pool can, in effect, appropriate the value of a second fund's management by investing all or a portion of its funds in the second fund. No commenter specifically addressed this issue. The Commission also requested comment concerning whether any additional protections, other than disclosure of applicable fees, are appropriate in light of the ''layering'' of fees that typically occurs at each level of a fund of funds structure. No comments specifically responded to this request.[140]

The Commission has determined to key non-performance disclosures with respect to a pool's investee pools to the new definition of major investee pool adopted as Rule 4.10(d)(5). Thus, for purposes of Rules 4.24 (f), (*l*) and (t) as adopted, disclosure is required with respect to investee pools allocated ten

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[131] As proposed, Rule 4.34 was numbered 4.33.

[132] Because proposed Rule 4.24(t) required disclosure with respect to major CTAs, it was indirectly addressed by the commenters who suggested changes to the major CTA definition.

[133] These were proposed Rules 4.24 (e)(3) (names), (f) (business backgrounds), (j) (conflicts of interest), (*l*) (litigation) and (t) (ownership in pool).

[134] As discussed above in Section IV, ''investee pool'' is now defined in Rule 4.10(d)(4). Former Rule 4.21 did not specifically address disclosures relative to these trading vehicles.

[135] *See* proposed Rule 4.24(e).

[136] *See* proposed Rule 4.24(j).

[137] As proposed in Rule 4.10(*l*), such investee pools would be ''major'' investee pools. Rule 4.10(d)(5) contains the definition, as adopted, of the term major investee pool, discussed above at paragraph B. of Section IV.

[138] Certain pools lock in initial investments for a specified period before allowing any redemptions. Because there are no Commission rules requiring that an opportunity for redemption of pool interests be afforded in very short timeframes as for investment companies, disclosure of volatility risks as required by new Rule 4.24(g) has added importance.

[139] 59 FR 25351, 25363.

[140] A number of commenters, however, claimed that the proposed revisions failed to adequately address the compliance problems faced by funds-of-funds. Some stated that obtaining required information from investee funds on a timely basis is often difficult or impossible for a variety of reasons, *e.g.*, because securities investee fund managers may consider the names of investee funds and managers to be proprietary; Rule 4.12(b) investee funds and securities trading partnerships report on a quarterly basis; partnerships that predominantly trade securities do not provide the same level of expense reporting as do pools; and if an investee pool is not soliciting participants when the investor pool prepares its Disclosure Document, the information from the investee pool may be unavailable or stale. Other commenters suggested that specific information regarding investee pools is unhelpful and may be misleading where the CPO frequently drops and adds investee pools. As a general matter, the Commission does not believe that fund-of-funds structures should be permitted to impair or diminish the duty of pool operators to provide timely material information to prospective and current pool participants. Consequently, the pool operator should ascertain the availability of such information prior to using pool funds for such investments. However, the Commission intends that the staff will continue to grant relief from reporting timeframes in fund-of-funds contexts as warranted by the circumstances presented.

percent or more of the offered pool's net assets, rather than the proposed twenty-five percent standard of the proposed major investee pool definition. Rule 4.24(j) (conflicts of interest involving the pool) effectively retains the ten percent threshold of the proposal.

B. Required Non-Performance Disclosures

1. Prescribed Non-Performance Statements, Table of Contents and Forepart Information: Rules 4.24 (a) through (d) for CPOs and 4.34 (a) through (d) for CTAs

Proposed Rules 4.24 (a) through (d) for CPOs and 4.33 (a) through (d) for CTAs would have specified the content and order of certain core information required to be placed at the front of Disclosure Documents. In particular, proposed Rules 4.24 (a) and (b) would have required a cautionary statement to be placed on the cover page of a pool Disclosure Document, followed by a risk disclosure statement. Rule 4.24(c) would have required a table of contents to follow the risk disclosure statement, and Rule 4.24(d) would have required specified descriptive information regarding the offered pool and the CPO to follow the table of contents in the forepart of the Disclosure Document. Proposed Rules 4.33 (a), (b) and (c) would have required the cautionary statement, risk disclosure statement and table of contents to be sequenced in the same manner in CTA Disclosure Documents as in pool documents. Proposed Rule 4.33(d) would have required inclusion of descriptive information regarding the CTA in the forepart.[141]

Two commenters favored standardizing the order of disclosures, asserting that it would promote consistency, clarity and comparability within the industry, both for potential investors and for regulators. Of the five commenters who opposed regulation of the placement of information, two suggested that the Commission's review process is capable of effectuating more prominent disclosure of underemphasized or ''buried'' information and one claimed that a summary cross-reference to the body of the document should provide sufficient clarity.

The Commission believes that investors are well served by requiring that certain items of particular significance be placed at the front of the Disclosure Document. With minor exceptions as noted below, it is adopting Rules 4.24(a) through (d) for CPO documents and Rules 4.33(a) through (d) for CTA documents (Rule 4.33 is renumbered 4.34) as proposed. The Commission notes that federal and state securities laws may also address the order and format of certain disclosures. These rules are not intended to supersede such requirements.

Placement of all required disclosures other than those specified in Rules 4.24(a) through (d) and 4.34(a) through (d) is left to the discretion of the registrant. Placement of information other than required disclosures is addressed by Rules 4.24(v) and 4.34(n), which are intended to maintain the prominence of required disclosures while giving discretion to the registrant with respect to placement of other matters, *e.g.*, supplementally provided performance information.[142] Thus, registrants will retain substantial discretion in arranging information in the Document. However, the required table of contents should facilitate review notwithstanding differences in placement of some items.

a. Cautionary Statement

Rules 4.24(a) and 4.34(a), which contain the requirements of former Rules 4.21(a)(18) and 4.31(a)(9), respectively, specify that a Cautionary Statement, *i.e.*, a statement that the Commission has not passed upon the merits of the investment or the adequacy of the Disclosure Document, appear on the cover page of the Document. Apart from comments generally urging that specific required statements and legends be minimized, no comments were received on the text of the proposed Cautionary Statement. The Commission is adopting Rules 4.24(a) and 4.33(a) as proposed (except that Rule 4.33(a) is renumbered 4.34(a)).[143]

b. Risk Disclosure Statement

The Risk Disclosure Statement specified in Rules 4.24(b) and 4.34(b) is required to be ''prominently displayed'' immediately following any disclosures required to appear on the cover page of the Disclosure Document as provided by the Commission or any applicable federal or state securities laws and regulations or by any applicable laws of non-United States jurisdictions.[144] As proposed, the revised Risk Disclosure Statement included page references to textual descriptions of fees and expenses, principal risk factors and the break-even point. Inadvertently omitted from the Proposing Release was the requirement for a legend (if applicable) to warn of potential liability in excess of the amount of a pool participant's investment. As explained in the Proposing Release, the proposed revisions to the prescribed Risk Disclosure Statements were also intended to address the potential for duplicative disclosure created by prior revisions of Rules 1.55[145] and 30.6(a)[146] by eliminating the need to provide two prescribed Risk Disclosure Statements, one for domestic futures trading and one for foreign futures trading.[147] Thus, the proposed revised statements addressed the risks of foreign as well as domestic transactions and revision of Rule 30.6(b) was proposed to cross-reference the Part 4 Risk Disclosure Statements. In addition, the proposal would have replaced the terms ''domestic'' and ''foreign,'' previously used to refer to contract markets or exchanges in foreign jurisdictions, with the terms ''United States'' and ''non-United States,'' in order to avoid confusion in the context of offerings in non-United States jurisdictions to non-United States participants for whom the term ''foreign'' does not mean ''non-United States.''

Some commenters encouraged minimizing required verbatim cautionary statements and legends. Two commenters suggested that the Commission prescribe one risk statement for inclusion in both CPO and CTA documents, incorporating all of the issues the Commission believes are necessary for investor protection, in order to increase the effectiveness of such disclosure. Another commenter asked whether the Risk Disclosure Statement would be more effective if set forth in the text of the Disclosure Document.

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[141] In connection with developing its proposed revisions to the disclosure rules, the Commission also considered whether a particular order for *all* required information should be mandated in order to ''standardize'' the entire format of Disclosure Documents. However, the Commission determined to propose, and now to adopt, only the limited sequence requirements contained in Rules 4.24 (a) through (d) and 4.34 (a) through (d).

[142] Rules 4.24(v) and 4.34(n) are discussed in detail in Section C of this Section VI.

[143] The requirement in Rules 4.24(a) and 4.34(a) that the Cautionary Statement be ''prominently'' displayed means that, as with the former rules, capital letters and boldface type are required. *See* Rule 4.1(b).

[144] The Risk Disclosure Statement must be printed in capital letters and in boldface type. Rule 4.1(b).

[145] 59 FR 25351, 25363. Rule 1.55 sets forth the basic risk disclosure requirement applicable to FCMs and IBs opening accounts for domestic futures and option contracts.

[146] Part 30 generally governs transactions in foreign futures and option contracts. Rule 30.6(a) requires an FCM or IB to deliver a risk disclosure statement (pursuant to Rule 1.55(b)) prior to the opening of a foreign futures or options account.

[147] 59 FR 25351, 25363.

The Commission is adopting Rules 4.24(b) and 4.34(b)[148] as proposed with the following exceptions. As adopted, Rules 4.24(b)(1) and 4.34(b)(1) recognize that foreign jurisdictions may require specific information on the cover page by adding the language ''or by any applicable laws of non-United States jurisdictions.'' As adopted, Rule 4.24(b) incorporates the requirement of former Rule 4.21(a)(17)(ii) to include in the Risk Disclosure Statement additional language if the pool participant's liability can exceed the purchase price of his interest in the pool. Further, Rule 4.34(b) as adopted omits reference to a break-even point. In addition, Rule 1.55 is being amended, as proposed, to provide that pools need not be treated as customers for purposes of delivery of the Risk Disclosure Statement required thereunder.

The Commission believes that the different risks and characteristics of pools as compared to direct trading through a managed account, perhaps most notably the difference between participating in a limited liability trading vehicle as opposed to an individually-managed account, warrant different risk disclosure statements. Accordingly, the Commission is not prescribing a single, common statement for both CPO and CTA Disclosure Documents. Further, the Commission believes that the information contained in the Risk Disclosure Statement is critical in order to inform potential investors as to many of the generic risks inherent in commodity interest trading, and that the importance of this information is appropriately highlighted by placing the Risk Disclosure Statement at the beginning of the document.

c. Table of Contents[149]

Rules 4.24(c) and 4.34(c) specify that the Disclosure Document must include a table of contents immediately following the Risk Disclosure Statement. The table of contents must show, by subject matter, the location of disclosures in the Disclosure Document. One commenter stated that a table of contents should be optional for smaller documents. Several commenters favored requiring a table of contents but requested latitude in its placement, *e.g.*, to permit it to appear on the back cover page. The Commission believes that placement of the table of contents at the beginning, rather than the end of (or elsewhere in) the Disclosure Document will be most helpful to investors, given the format of most pool documents, and that the benefits of a table of contents outweigh any burdens attendant to its preparation. The Commission thus is adopting as proposed the requirement that a table of contents be included in all Disclosure Documents immediately following the Risk Disclosure Statement.

d. Information To Be Included in Forepart[150]

Proposed Rules 4.24(d) and 4.33(d) would have required that specified basic information appear immediately following the table of contents, in the forepart of the Disclosure Document. With respect to CPO documents, this information would have included the following: The name, business address, business phone number and form of organization of the offered pool and of the CPO (and if the pool's address is a post office box or is outside the United States, the location of the books and records); a statement whether the offered pool is privately offered under the Securities Act, a multi-advisor pool or a limited risk pool;[151] the closing date of the pool offering (or a statement that the offering is continuous); the date the Disclosure Document will first be used; and the break-even point of the pool.[152] The forepart of a CTA document would have been required to contain the business address, business phone number and form of organization of the CTA (and if the address is a post office box or is outside the United States, the location of the books and records) as well as the date the Disclosure Document will first be used.

The Commission is adopting Rules 4.24(d) and 4.33(d) as proposed, with the following exceptions. Instead of requiring a ''statement whether the pool is'' privately offered, a multi-advisor pool or a limited risk (principal-protected) pool, Rule 4.24(d)(3) requires disclosure only in the event that one or more of such descriptions applies to the offered pool. In addition, instead of the date the Disclosure Document will actually be used, the forepart must indicate the date the CPO or CTA first intends to use it.[153] Cross-references have been conformed and corrected. Finally, proposed Rule 4.33(d) is adopted as 4.34(d).

e. Persons To Be Identified

Proposed Rule 4.24(e) would have required disclosure of names of the CPO's principals, the trading manager (if any) and its principals, each investee pool allocated at least ten percent of the assets of the offered pool, each CTA allocated at least ten percent of the pools initial margin and option premiums, the person who will make trading decisions for the offered pool, and, if known, the FCM to be used by the offered pool. Proposed Rule 4.33(e) would have required a CTA to name each of its principals, as well as any FCM or IB the CTA's client will be required to use.

Rule 4.24(e), as adopted, eliminates the initial margin and premiums standard for CTA disclosure and requires instead that only CTAs (and investee pools) that are ''major'' must be named. Rule 4.24(e) also requires identification of any IB the offered pool will use, and otherwise is adopted as proposed. Rule 4.33(e) is adopted as proposed except that it is renumbered 4.34(e).

2. Business Background: Rules 4.24(f) for CPOs and 4.34(f) for CTAs

As proposed, Rule 4.24(f) would have required disclosure in a pool document of the business backgrounds of the CPO, any trading manager of the pool, major CTAs, and the operators of major investee pools. The only principals of the foregoing for whom disclosure of business backgrounds would have been required are those ''who participate in making trading or operational decisions * * * or who supervise those so engaged.'' Proposed Rule 4.33(f) would have required a CTA document to provide the business background of the CTA and the principals thereof participating in making trading or operational decisions.

Former Rule 4.21(a)(2) required business backgrounds for the CPO, the CTA and *all* of their respective principals, and, similarly, former Rule 4.31(a)(2) called for the backgrounds of the CTA and all of its principals. The

[148] Rule 4.34(b) was proposed as Rule 4.33(b).

[149] Neither former Rule 4.21 for CPOs nor former Rule 4.31 for CTAs required a table of contents. However, most Disclosure Documents reviewed by the Division contain such a table. Further, Form S–1, the form most frequently used to register pool offerings with the SEC, requires ''a reasonably detailed table of contents showing the subject matter of the various sections or subdivisions of the prospectus and the page number on which each section or subdivision begins.'' *See* Item 502(g) of Regulation S–K, 17 CFR 229.502(g) (1994), incorporated by reference into Item 2 of Form S–1, 17 CFR 239.11 (1994). The Commission believes that a table of contents should contribute to making the disclosure document ''reader-friendly'' and readily reviewable.

[150] Neither former Rule 4.21 nor 4.31 required specified information to be placed in the forepart of the Disclosure Document.

[151] As discussed at Section IV above, new Rule 4.10(d)(3) replaces the proposed term ''limited risk pool'' with the term ''principal-protected pool'' (while continuing to define it, as proposed, as pool designed to limit the loss of the initial investment of its participants).

[152] The term ''break-even point'' is discussed in Section IV above.

[153] Proposed Rules 4.24(d)(4) and 4.33(d)(2) had required ''[t]he date when the Disclosure Document will first be used.''

proposed revisions were designed to reduce the number of principals subject to business background disclosure and, in the context of trading advisors and operators of investee pools, restricted business background disclosure to major CTAs and the operators of major investee pools.

Commenters generally supported the proposed reduction of business background disclosure. Six suggested further limiting disclosure with respect to principals by deleting the words ''or operational'' and effectively employing the definition of ''trading principal'' in Rule 4.10(e)(2).[154]

The Commission is adopting Rules 4.24(f) and 4.33(f) as proposed, except that the provision with respect to principals who participate in making trading or operational decisions for the pool or supervise persons so engaged is revised to make clear that officers and directors are included among the principals whose business background is required, as only shareholders and other passive investors who would constitute principals were intended to be excluded. Proposed Rule 4.33(f) is adopted as Rule 4.34(f). The requirement to disclose business backgrounds for principals who participate in making operational decisions for a pool operator or advisor is retained because such persons can have as significant an effect on the performance of the pool operator or advisor as those who make its trading decisions. For example, the persons who supervise sales solicitations, manage the pool's back office and perform compliance functions may be wholly uninvolved in the pool's trading yet integral to the pool's success or failure. Accordingly, the Commission believes that the business backgrounds of such persons should be disclosed to prospective participants or clients.[155] As noted above, the Commission intends that the principals who participate in making trading or operational decisions for the pool or who supervise persons so engaged would include all principals other than purely passive investors or owners.

3. Principal Risk Factors: Rules 4.24(g) for CPOs and 4.34(g) for CTAs[156]

As noted above, Rules 4.24(b) and 4.34(b) require the inclusion, at the beginning of the Disclosure Document, of a standardized Risk Disclosure Statement that generically describes the risks of the investment. Proposed Rules 4.24(g) and 4.33(g) would have required that the prescribed generic risk disclosures be supplemented by a particularized discussion of the ''principal risk factors'' specific to the pool or trading program being offered, including, without limitation, risks due to volatility, leverage and counterparty creditworthiness. As the Commission explained in the Proposing Release, this requirement was designed to elicit a ''plain English'' discussion of the risks of the offered investment, with particular attention to the risks created by over-the-counter transactions.[157] For example, as noted in the Proposing Release, the discussion of principal risk factors should address the volatility of an offered pool investment as compared to investments in other types of trading vehicles and other risks relevant to the trading program to be followed, such as risks resulting from concentration of investments in particular commodities or from trading foreign contracts that are subject to currency rate fluctuations. Other risks cited included risks inherent in transactions in off-exchange instruments and risks arising from the lack of relevant experience of the CPO or CTA.[158] The Commission noted that in establishing an express requirement for disclosure of principal risk factors, it was essentially codifying disclosure requirements previously required under the obligation to disclose all material information or under other provisions of the former rules. This provision also accords with existing SEC requirements for publicly offered funds.[159]

The Commission requested comment as to whether additional guidance should be given in the rules as to the types of risk factors that should be discussed and as to any specific factors that should be identified in this context. The commenters did not suggest any additional specific risk factors. One commenter supported the proposed requirement for a particularized discussion of the risks beyond the standardized required risk disclosure. Another urged that the rules not list specific required risk factors, since risks vary by pool or program, and such a requirement would mean that risks that are important in certain contexts but not in others would be required to be disclosed in the same manner in all contexts. Another commenter stated that discussion of counterparty creditworthiness is not warranted for a pool that restricts its trading to exchange-traded instruments. One commenter proposed that the level of risk factor disclosure with respect to an investee pool be determined by the percentage of assets allocated to such investee pool.

The Commission is adopting Rules 4.24(g) and 4.33(g) as proposed (renumbering proposed Rule 4.33(g) as 4.34(g)) with certain modifications designed to provide more specific guidance as to the types of disclosures called for in the discussion of principal risks. The principal risk factor discussion must now include, without limitation, risks relating to volatility, leverage, liquidity and counterparty creditworthiness, as applicable to the types of trading programs to be followed, trading structures to be employed and investment activity expected to be engaged in by the offered pool. Similarly, under Rule 4.34(g), the focus is on the trading program and the types of transactions and investment activity expected to be engaged in pursuant to the trading program. As noted, the specific types of risks cited in the rules (volatility, leverage, liquidity and counterparty creditworthiness) are illustrative, not exclusive, are likely to be significant across a wide range of trading programs and investments and thus are logical starting points for a discussion of principal risk factors. The final rule includes specific reference to

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[154] Under the rule amendments as proposed and as adopted, the ''trading principal'' concept is not used in connection with non-performance disclosure requirements. *See* Rule 4.25(c) for CPOs and Rule 4.35(b) for CTAs.

[155] The Commission emphasizes that while disclosure of business backgrounds of principals is being limited to officers, directors and other operational or trading principals, the names of all principals of the CPO, trading manager, major CTAs, and operators of major investee pools continue to be required to be disclosed in the Disclosure Document. *See* Rules 4.24(e) for CPOs and 4.34(e) for CTAs.

[156] Former Rules 4.21 and 4.31 did not contain any specific requirements applicable to the particular risks of the pool or trading program.

[157] 59 FR 25351, 25364. These risks may differ materially from those entailed in exchange-traded futures and option transactions, which generally are backed by clearing organization guarantees, daily marking-to-market and settlement, and segregation and minimum capital requirements applicable to intermediaries. Transactions entered directly between two counterparties generally do not benefit from such protections and expose the parties to the risk of counterparty default.

[158] 59 FR 25351, 25364.

[159] Public securities offerings are required by Item 503(c) of Regulation S–K (17 CFR 229.503(c) (1994)) to include immediately following the cover page of the prospectus (or following the summary, if one is included) ''a discussion of the principal factors that make the offering speculative or one of high risk.'' Possible risk factors included in Item 503(c) include absence of an operating history, absence of profitable operations in recent periods, financial position, nature of the registrant's business and absence of a previous market for the offered securities. SEC Release Number 33–6900, which provides guidance with respect to disclosure requirements for limited partnership offerings and roll-up transactions, requires that the cover page of a limited partnership prospectus indicate the most significant risk factors ''highlighted through the use of a concise list of bullet-type statements.'' (17 CFR 231.6900 (1994)).

''liquidity'' as a risk factor, in recognition that the risk of illiquidity is one that arises in a wide range of instruments and that liquidity issues may often be linked to the other identified risk factors.

Rule 4.24(g) as adopted provides three contexts in which such risks should be considered, the trading programs to be followed, the trading structures to be employed and the investment activity expected to be engaged in by the offered pool. Risk factors specific to each context should be discussed. For example, this discussion should indicate any material historical or expected volatility of the trading program and any other special characteristics of the trading program, such as concentration in a particular commodity, lack of trading history, or negative performance history associated with the trading program. The trading structures or vehicles to be employed may also present significant risks. For example, multi-CTA and multi-investee-fund structures generally involve more complex fee structures than other pools and their profit potential may be adversely affected as a result of the potential for the pool to maintain offsetting positions due to the separate trading of various CTAs and investee funds. The specific types of investment activity in which the pool is expected to engage must also be examined to identify principal risk factors. For example, highly leveraged off-exchange transactions such as some types of swaps, may present risks of rapid price movements, illiquidity, lack of transparency and the potential for counterparty default which may not be material in the context of domestic exchange-traded futures contracts. Given the wide range of potential pool investments, the CPO must determine on a case-by-case basis what risk factors must be addressed in light of the contemplated trading and investment activity of the pool.

A CPO must make a determination whether the risks affecting each investee pool (or investee fund), when considered in the context of the investor pool's participation in such investee pool (or fund), constitute principal risk factors of the investor pool. In determining whether counterparty creditworthiness is a principal risk factor in the context of a given pool offering or trading program, factors such as the use of instruments other than those that are traded on United States contract markets must be considered.[160]

[160] As shown by the recent events involving the collapse of Barings, PLC, under certain circumstances exchange-traded instruments may be subject to some of the same risks as over-the-counter transactions.

4. Investment Program and Use of Proceeds: Rule 4.24(h) for CPOs [161]

Proposed Rule 4.24(h) would have consolidated under the caption ''Use of Proceeds'' the provisions of former Rule 4.21(a)(1)(viii), which required a description of the types of commodity interests the pool is expected to trade and any restrictions on such trading, with those of former Rule 4.21(a)(9), which required disclosure of the manner in which the pool would fulfill its margin requirements and the form in which non-margin funds would be held. As a result, taken together, former Rules 4.21(a)(1)(viii) and (a)(9) called for disclosure of both the commodity interest trading expected to be engaged in by the pool and all other types of trading, investments, custodial arrangements and other uses of the funds of the pool. Proposed Rule 4.24(h) thus would have unified previously separate related disclosures to create a single, cogent discussion of all of the contemplated uses of pool funds. In addition to integrating disclosures previously required under separate rule provisions, Proposed Rule 4.24(h) was designed to reflect the increasingly diverse nature of non-futures investments made by pools, for example, interests in other commodity pools, commercial paper and foreign securities.

Several commenters recommended that use of proceeds disclosure requirements minimize (or eliminate) information regarding ''normal'' investment uses and concentrate on (or be limited to) ''unusual'' uses of assets or uses that present special risks to the investor. Several commenters argued that expanded use of proceeds disclosures have unnecessarily lengthened Disclosure Documents, resulting in disproportionate emphasis on standard or mundane investments and obscuring the pool's primary business objectives. Some commenters urged that the use of pool assets in securities trading that is independent of rather than incidental to a pool's commodity interest trading should not require disclosure. With respect to participation in investee pools or funds, one commenter suggested that only a general statement that the pool would invest in investee pools or funds should be sufficient. Another commenter suggested that the requirement for use of proceeds disclosure should be based upon the percent of assets allocated to the investee pool and that if the investment involved less than ten percent of the offered pool's assets, disclosure should not be required. Two commenters criticized the requirement to disclose whether (and in what form) assets are held in segregation.

[161] Because of the differences between CPOs and CTAs, the Commission did not propose nor is it now adopting any general ''use of proceeds'' disclosure requirement for CTAs. However, both new Rules 4.24(h)(2) for CPOs and Rule 4.34(h) for CTAs require a description of the trading progrm that will be used for the pool or managed account client.

Based upon its review of the comments received and of the overall content of the proposed and final rules, the Commission has determined to modify proposed Rule 4.24(h) in order to provide greater clarity and specificity as to the disclosures called for. In essence, proposed Rule 4.24(h) was designed to elicit a description of the types of interests in which the proceeds of the offering would be invested and of the trading programs to be followed. To better reflect the overall intent and scope of this provision, it has been retitled ''Investment Program and Use of Proceeds'' and the text has been restructured and refined to provide more specific guidance as to the minimum disclosures called for. As revised, Rule 4.24(h) calls for four main types of information: Information about the types of commodity interests and other interests which the pool will trade; a description of the trading and investment programs and policies that will be followed by the offered pool; a summary description of the pool's commodity trading advisors and investee pools or funds; and information concerning the manner in which the pool will fulfill its margin requirements, the approximate percentage of the pool's assets that will be held in segregation and related matters. With respect to each topic, explanatory text has been added to clarify the types of information to be provided. For example, information concerning the ''types of commodity interests or other interests the commodity pool operator intends that the pool will hold or trade'' is to include the approximate percentage of the pool's assets that will be used to trade commodity interests, securities and other types of interests. The provision also calls for the different types of interests in which the pool will trade to be categorized so as to provide a meaningful explanation of the contemplated trading and investment portfolio. Thus, the rule provides for categorization by the type of commodity or market sector, type of security, whether traded or listed on a regulated exchange market, maturity ranges, and investment rating, as applicable. Further, the regulatory status of such

interests, *i.e.*, the extent to which they are subject to state or federal regulation, foreign regulation or supervision by a self-regulatory organization, is called for.

Second, Rule 4.24(h)(2) requires a description of the trading and investment program and policies to be followed by the offered pool. This description must include an explanation of the methodologies and data used to select CTAs, investee pools and types of investment activity to which pool assets will be committed. The objective is to provide an explanation of the basic trading and investment approach to be followed by the pool, including, if applicable, an explanation of the systems used to select the pool's advisors and the types of investment activity in which the pool will engage.[162]

A new subparagraph, designated as Rule 4.24(h)(3), calls for a narrative description of the major commodity trading advisors and investee funds to which the pool will commit funds. This discussion is required to include percentage allocations of pool assets to major CTAs and investee pools and funds, a description of the trading programs to be followed by such advisors, and for each such advisor and investee fund, the types of interests traded and material information as to the advisor's historical experience trading such program, including material information as to volatility, leverage and rates of return and the length of time during which the advisor has traded such program. Similarly, for the pool's investee pools or funds, the description should extend to the nature and operation of such investee pools and funds, including for each investee pool or fund the types of interests traded, material information as to volatility, leverage and rates of return for such investee pool or fund and the period of its operation.

Finally, Rule 4.24(h)(4), like the proposed ''Use of proceeds'' section, calls for information as to the manner in which the pool will fulfill its margin requirements and the approximate percentage of the pool's assets that will be held in segregation pursuant to the Act and the Commission's regulations, the nature of anticipated non-cash margin deposits and to whom income generated by margin assets will be paid.

5. Fees and Expenses; ''Break-Even'' Analysis for CPOs: Rules 4.24(i) for CPOs and 4.34(i) for CTAs[163]

Proposed Rule 4.24(i) was intended to provide in a single location a complete discussion of costs incurred by a commodity pool for all purposes. The proposed rule combined the requirements of former Rule 4.21(a)(7), which called for a description of the expenses that the CPO knew or should have known had been incurred in the preceding year or would be incurred in the current year (*e.g.*, fees for management, trading advice, brokerage commissions, legal advice, accounting and organizational services), with those of former Rule 4.21(a)(14), which required disclosure of fees and commissions paid in connection with solicitations for the pool.[164] In addition, it called for a description of certain fees and expenses that were not specifically enumerated in the former rules but that nonetheless constitute material information about which a prospective investor should be informed. These include clearance fees and fees paid to national exchanges and self-regulatory organizations, incentive fees (including any disproportionate share of profits allocated to the CPO, *i.e.*, a right of the CPO to receive a greater than pro-rata share of the pool's profits), and fees and expenses incurred as a result of investments in investee pools and other investment vehicles or in connection with funding the guarantee of a principal-protected pool. The proposed rule also required an explanation of the calculation of the pool's ''break-even point.''

With respect to CTAs, proposed Rule 4.33(i) differed from former Rule 4.31(a)(4) only in requiring that if a fee is determined by reference to a base amount such as net assets or net profits, the manner in which such base amount will be calculated must be explained, where former Rule 4.31(a)(4) simply required that such base amount be defined.[165]

The Commission received numerous comments in response to its request for comment as to whether a description of fees and expenses should continue to be required or whether the break-even analysis is sufficient to accurately describe the costs of participation in a pool. These comments included the following: That a break-even analysis is sufficient unless in the CPO's judgment more information is required to make the break-even analysis more understandable; that investors benefit from receiving a separate, more comprehensive description of applicable fees than is contained in a break-even discussion; that for a pool in operation for more than one year the prior year's actual expenses should suffice with no requirement for estimated expenses; that estimated expenses be required to be disclosed in a manner similar to that required under SEC rules applicable to mutual funds; and that a description of fees and expenses that are paid by the CPO or the CTA out of their own assets on behalf of the pool should not be required. Some commenters asserted that calculation of a break-even point would be difficult or impossible for pools with no maximum amount of capital that can be raised, for pools invested in other collective investment vehicles, and for multi-advisor pools with high CTA turnover and reallocation. One commenter suggested a convention (such as 2% of average net asset value) for approximating the profit shares to be paid in a multi-advisor fund with non-netted incentive fees.

Several commenters argued that estimating incentive and other fees would be difficult or impossible for CPOs of existing pools as well as operators of new pools. One commenter, however, stated that since the CPO establishes and understands the fee structure (and is allowed to make and to state any necessary assumptions) it is incorrect to argue that a break-even analysis cannot be provided because fees cannot be estimated.

The Commission is adopting Rules 4.24(i) and 4.33(i) as proposed (renumbering proposed Rule 4.33(i) as 4.34(i)). For pool Disclosure Documents both the break-even analysis and the narrative fee and expense description are required because the Commission believes that each serves a valuable purpose. A description of each separate fee and expense may not convey a clear understanding of the actual portion of each pool participation absorbed by the aggregate fees and expenses of the pool. To foster a better understanding of the nature of those costs and their impact upon an investment in the pool, the revised rules require that the narrative description of fees and expenses, which is designed to explain the basis for each such expenditure, be accompanied by a

[162] The requirement in proposed Rule 4.24(h)(1) to disclose ''any restrictions or limitations on such interests or trading required by the pool's organizational documents or otherwise'' (originally part of former Rule 4.21(a)(1)(viii)) was revised to refer to ''any *material* restrictions or limitations * * *''

[163] The Commission's former disclosure rules did not require a break-even analysis.

[164] By way of clarification, as proposed and as adopted, Rule 4.24(i) also requires that disclosure of fees paid in connection with solicitations for the pool must include trailing commissions as well as any type of benefit that may accrue to persons engaged in such solicitations.

[165] The same change was also incorporated in proposed CPO Rule 4.24(i).

tabular presentation of fees and expenses from all sources, setting forth how the break-even point for the pool is calculated (''break-even analysis''). Where specific components of the break-even analysis are not available or are not subject to precise determination, good faith estimates should be made, based on reasonable assumptions properly disclosed. As noted above, the ''break-even point'' for the pool is required by Rule 4.24(d)(5) and 4.10(j) to be set forth as a separate item in the forepart of the Disclosure Document, immediately following the table of contents, and must be expressed both as a dollar amount and as a percentage of the minimum unit of initial investment. The break-even analysis provides an explanation, in tabular form, of how the break-even point is calculated, taking into account all fees, expenses and commissions applicable to the pool. Rule 4.10(j) requires that the break-even point be prepared in accordance with rules promulgated by a registered futures association pursuant to section 17(j) of the Act. As noted above, NFA has adopted (and the Commission has approved) an Interpretive Notice to accompany NFA Compliance Rule 2–13, setting forth how a break-even point must be calculated and the format in which such calculation must be disclosed.

The Commission is clarifying that the break-even point must represent the trading profit the pool must realize in the first year of an investor's participation in order for the investor to recoup his initial investment, and Rule 4.10(j) as adopted so states. Revision of the break-even point is required for ongoing pool offerings whenever the Disclosure Document is amended or updated. Of course, if the actual break-even point becomes materially different from that which appears in the Disclosure Document, amendment is required.

As proposed and as adopted, Rules 4.24(i) and 4.34(i) require disclosure of fees and expenses expected to be incurred in the current fiscal year, including estimated figures if actual amounts cannot be determined. The Commission believes that reliance solely upon the prior year's actual fees and expenses may be misleading, especially if the CPO has reason to anticipate changes in investment strategies or advisors or market conditions. With respect to fees and expenses borne entirely by the CPO or the CTA, disclosure should not be necessary unless the compensation paid by the pool or account to the CPO or CTA is increased as a result. Of course, disclosure is required if such fees and expenses are subsequently charged to the pool or account.

Where a fee or expense item is variable or otherwise difficult to determine (*e.g.*, in the case of a multi-advisor pool rapidly substituting and re-allocating among numerous advisors), the narrative discussion required by Rule 4.24(i) must indicate a range based upon the CPO's advisor selection criteria, investment objectives and other business practices. For purposes of the break-even analysis, however, a good faith estimate should be used, as discussed above, and the assumptions for such estimate disclosed. This situation illustrates the benefit of requiring both the break-even analysis and the narrative discussion.

The Commission believes that the revised fee and expense disclosure requirements better codify disclosures required under the former rules, that the break-even analysis makes such disclosures more understandable, and that the revised requirements will better assist readers of Disclosure Documents in understanding the nature and effect upon investment returns of costs incidental to the offering and operation of the pool or trading program.

6. Conflicts of Interest: Rules 4.24(j) for CPOs and 4.34(j) for CTAs; Related Party Transactions: Rule 4.24(k) for CPOs [166]

a. Conflicts of Interest—CPOs

Proposed Rule 4.24(j) called for a full description of any actual or potential conflicts on the part of: (a) The pool's CPO, trading manager (if any), CTAs allocated at least ten percent of the pool's initial margin and premiums, the operators of investee pools allocated at least ten percent of pool assets; (b) any principal of the foregoing; and (c) any person providing services to the pool or soliciting participants for the pool. Proposed Rule 4.24(j) specifically referred to arrangements whereby a person benefits from the pool's use of a particular FCM or IB (specifically including payment for order flow and soft dollar arrangements) [167] or from the investment of pool assets in investee pools or other investments. Former Rule 4.21(a)(3) required disclosure of conflicts involving the following persons or their principals: The CPO, the CTA, any FCM that will execute the pool's trades, and any IB through which the pool's trades will be introduced. The former rule specified that such description should include any arrangement whereby the CPO or the CTA might benefit directly or indirectly from maintenance of the pool's account with the FCM or introduction of the account by the IB. The proposed rule would have retained the requirement to disclose conflicts of interest on the part of the CPO and its principals but, subject to the requirement that all material information be disclosed, generally would have eliminated such disclosure with respect to CTAs allocated less than ten percent of the pool's futures margins and option premiums. Further, rather than limiting the disclosure of conflicts of interest to specified categories of registrants, such as FCMs and IBs, specifically identified in the former rule, the proposed rule would have encompassed conflicts of interest on the part of any person providing services to, or soliciting participants for, the pool. As noted in the Proposing Release, the purposes of conflict of interest disclosure are not confined to conflicts involving a Commission registrant.[168] Unregulated parties such as a CPO affiliate acting as counterparty to over-the-counter transactions with the pool may be equally relevant for such purposes. Finally, unlike former Rule 4.21(a)(3), proposed Rule 4.24(j) would have specifically referenced payment for order flow and soft-dollar arrangements as types of disclosable arrangements by which a person may benefit from maintenance of the pool's account with an FCM or the introduction of the pool's account by an IB. As with the former rule, disclosure of all material conflicts would continue to be required, whether

[166] Former Rules 4.21(a)(3) for CPOs and 4.31(a)(5) for CTAs addressed conflicts of interest. The Commission's former disclosure rules did not contain any specific requirements with respect to related party transactions.

[167] Payment for order flow is a practice whereby FCMs and IBs compensate CPOs (and CTAs) for directing customers to them. Soft dollar arrangements consist of arrangements whereby customer or pool funds are used to pay for research or other services that benefit the CPO (or CTA). Both practices have concerned regulators because, among other things, they are often inadequately disclosed. *See Market 2000, An Examination of Current Equity Market Developments: Study V, Best Execution* (Division of Market Regulation, SEC, January 1994). The SEC recently adopted Rule 11Ac1–3 and amendments to Rule 10b–10 (17 CFR 240.10b–10 (1994)) under the Securities Exchange Act of 1934 15 U.S.C. 78a *et seq.* to require enhanced disclosure on customer confirmations and account statements (and upon opening of new accounts) with respect to payment for order flow practices. Release No. 34–34902, 59 FR 55006 (November 2, 1994). At the same time, revisions to Rule 11Ac1–3 and further amendments to Rule 10b–10 were proposed. Release No. 34–34903, 59 FR 55014 (November 2, 1994). The effective date of Rule 11Ac1–3 and the amendments to Rule 10b–10 has been postponed to October 2, 1995 (Release No. 34–35473, 60 FR 14366, March 17, 1995).

[168] 59 FR 25351, 25365.

or not specifically called for under proposed Rule 4.24(j).[169]

Several commenters supported the expansion of the range of required conflicts disclosure to include persons not registered with the Commission. However, several commenters noted that conflict of interest disclosures have expanded beyond reasonable measure and recommended restricting disclosure to ''actual'' as opposed to ''potential'' conflicts. Others urged that only those conflicts that the CPO reasonably believes might be considered material should be required. One commenter suggested that only conflicts likely to have a direct material adverse effect on the pool, its performance or its relationships with its FCMs should be required.

The Commission is adopting Rule 4.24(j) generally as proposed. However, the Commission has added to the final rule new § 4.24(j)(2) which requires description of ''(a)ny other material conflict of interest involving the pool,'' to make clear that material conflicts involving non-major CTAs and the operators of non-major investee pools must be disclosed. Under the general materiality standard, disclosure of conflicts of interest on the part of CTAs and CPOs of investee pools below the ten percent thresholds is required if, in light of all relevant circumstances, including, for example, the nature and severity of the conflict, such disclosure would be material to prospective pool participants. Thus, the additional subparagraph will reinforce the dictates of the general materiality standard stated in Rule 4.24(w) in this area.

With respect to the comments concerning the desirability of limiting conflict of interest disclosures, for example, by requiring the disclosure only of ''actual'' as opposed to ''potential'' conflicts of interest or material conflicts, the Commission does not believe that a clear bright line distinction of this nature can meaningfully be drawn on a prospective basis. A situation that may ripen into a conflict of interest, although it has not done so as of the date of the Disclosure Document, nonetheless may be as material as an actual conflict that currently exists. However, the Commission does believe that conflict of interest disclosure should be guided by a rule of reason and that only those conflicts that are reasonably likely to be material must be disclosed. The Commission stresses, however, that materiality in this context should not necessarily be determined on a strictly quantitative basis, *e.g.*, in terms of the expected quantitative impact on a pool's rate of return, but rather, on the basis of what a prospective investor would consider to be material.

b. Conflicts of Interest—CTAs

Proposed Rule 4.33(j) differed from former Rule 4.31(a)(5) in that the proposed rule would have added the words ''(a) full description of'' any actual or potential conflict. Also, the following paragraph, which was proposed as part of the conflicts of interest provision for CPO Disclosure Documents in proposed Rule 4.24(j), was inadvertently omitted from Rule 4.33(j) in the Proposing Release, and it has been included in the rule as adopted:[170]

(2) Included in the description of such conflict shall be any arrangement whereby the trading advisor or any principal thereof may benefit, directly or indirectly, from the maintenance of the client's commodity interest account with a futures commission merchant or the introduction of that account through an introducing broker (such as payment for order flow or soft dollar arrangements).

No comments were received specifically addressing proposed Rule 4.33(j). The Commission is adopting Rule 4.33(j) as proposed (renumbering it as 4.34(j)), with the addition of the foregoing paragraph, including the reference to payment for order flow and soft dollar arrangements.

c. Related Party Transactions

Proposed Rule 4.24(k) would have required that the CPO describe and discuss the costs to the pool of any material transactions or arrangements between the pool and any person affiliated with a person providing services to the pool for which there is no publicly disseminated price. Although the rules previously contained no corresponding provision, the Commission believes that this type of disclosure is already mandated in many cases under the general requirement that material information be disclosed. However, given the increasing use of over-the-counter transactions in which pools contract with their CPO or an affiliate of the CPO as counterparty to the transaction, the Commission believes that an express requirement for such disclosure is warranted.

Two commenters claimed that computing costs of related party transactions is difficult. One asked the Commission to consider requiring disclosure of the benefit to the related entity and the potential detriment to the pool. Another commenter stated that it will be very difficult, if not impossible, for a sponsor to quantify the spreads charged on forward trades between its pools and counterparties affiliated with the sponsor and urged that no greater cost detail be required than ''cannot be quantified but will constitute a significant cost to the pool.'' One commenter urged that if Rule 4.24(k) applies to investee pools, no disclosure should be required with respect to pools allocated less than ten percent of pool assets; an intermediate level of disclosure should be required for pools allocated at least ten but less than twenty-five percent; and full disclosure should be required for pools allocated more than twenty-five percent.

The Commission is adopting Rule 4.24(k) as proposed (with a word order change for clarity).[171] In situations in which a transaction is undertaken with an affiliate for which there is no publicly disseminated price, the Commission recognizes that quantification of the ''cost'' thereof to the pool may be difficult. In such contexts, the Commission believes that, as suggested by a commenter, an explanation of the benefit to the related party and the potential detriment to the pool may be sufficient. In other cases, a good faith estimate or a qualitative description of the potential negative impact on the pool may be sufficient. The fact that such transactions are entered into on a noncompetitive basis should also be highlighted. With respect to investee pools, the Commission does not believe that the three-level disclosure suggested by one of the commenters is warranted because Rule 4.24(k) applies to transactions or arrangements that directly involve, and that are material to, the offered pool.[172] Thus, in applying Rule 4.24(k) to investee pool transactions, pool operators may consider the extent of the pool's allocation of funds to an investee pool in assessing the materiality of a related party transaction.

7. Litigation: Rules 4.24(l) for CPOs and 4.34(k) for CTAs

As proposed, Rule 4.24(l) would have required disclosure of any material administrative, civil or criminal action within the preceding five years against the pool's CPO, trading manager (if any), major CTAs and operators of major

[169] Former Rule 4.21(h) and new Rule 4.24(w).

[170] Except for the language in parentheses, the paragraph is identical to the last paragraph of former Rule 4.31(a)(5)(i). The parenthetical language conforms to proposed Rule 4.24(j) for CPOs.

[171] *See* 59 F.R. 25351, 25365 n.67 for a discussion of the litigation involving Stotler Funds, Inc., as an illustration of the purpose of this requirement.

[172] Moreover, as adopted, the revised rules do not retain the proposed three-level disclosure framework for past performance disclosures.

investee pools, any principal of the foregoing, and the pool's FCMs and IBs (if any). Disclosure of actions that were concluded by adjudication on the merits in favor of the listed persons would not have been required. Proposed Rule 4.33(k) would have required similar disclosure with respect to the CTA and with respect to the FCM and IB required to be used by the CTA's client.

Former Rule 4.21(a)(13) required disclosure of any action against a pool's CPO, CTA, FCM, IB or any of their principals within five years preceding the Document date without regard to the outcome. Former Rule 4.31(a)(7) required similar disclosure with respect to the CTA, any FCM or IB the client is required to use, and any principal of those persons. If there had been no actions against any of the listed persons, the former rules required a statement to that effect.

In addition to eliminating the requirement to disclose actions resolved on the merits in favor of one of the identified persons, the proposed rules would have substantially reduced required litigation disclosures concerning FCMs and IBs. First, the basic determinant of whether FCM or IB litigation would be material would be the extent of potential impact of the proceeding upon the FCM or IB, unless the proceeding were brought by the Commission or another regulatory or self-regulatory organization. The proceeding would be disclosable only if it would be required to be disclosed in the notes to the FCM's or IB's financial statements prepared pursuant to generally accepted accounting principles.[173] Disclosure of actions brought by the Commission and other regulatory agencies was also proposed to be streamlined. Commission actions would have been deemed material except for concluded actions which did not result in civil monetary penalties exceeding $50,000 and did not involve allegations of fraud or willful misconduct or which was adjudicated on the merits in favor of the specified person. Actions brought by other federal or state regulatory agencies or domestic or foreign self-regulatory organizations would have been required to be disclosed either if they were required to be disclosed in the notes to financial statements as discussed above or if they involved allegations of fraud or willful misconduct. Proposed Rule 4.24(*l*) also would expressly have required disclosure of litigation against a pool's trading manager, if any, and its principals, a requirement previously encompassed within the former requirement for disclosure of litigation against CTAs.

Proposed Rules 4.24(*l*) and 4.33(k) thus represented a reduction of required litigation disclosure, particularly with respect to FCMs and IBs. The scope of previously required litigation disclosures as to CTAs would have been limited under proposed Rule 4.24(*l*) to major, as opposed to all, CTAs for the pool, and only litigation against operators of major investee pools would be included.[174] Litigation involving FCM and IB principals was not included in the proposed rule.

Commenters generally supported the proposed changes but suggested certain further revisions. One commenter urged that *all* Commission and other regulatory matters concluded favorably with respect to the respondent (whether or not involving allegations of fraud or willful conduct) should be considered *not* material. Several commenters contended that litigation against FCMs is immaterial because such litigation generally does not jeopardize customer funds and virtually all FCMs have been subject to litigated customer claims. One commenter stated that only litigation required to be disclosed in the FCM's financial statements (and not the regulatory matters required by Rule 4.24(*l*)(2) (ii) and (iii)) is material and should be required in CPO and CTA Documents. Other commenters contended that CPOs and CTAs must rely upon the FCM to furnish its litigation history and are unable to verify independently the information that is provided. Consequently, commenters recommended, variously, that litigation disclosures be limited to those actions against an FCM that the FCM reasonably believes are likely to have a material adverse effect on the FCM's ability to provide brokerage services to the pool or managed account program or upon the investor's decision to place his funds with that FCM, or actions *actually* disclosed in an FCM's or IB's financial statements. Another commenter asserted that the impact of the litigation disclosure requirement upon funds-of-funds is unclear.

The Commission is adopting Rules 4.24(*l*) and 4.33(k) as proposed (renumbering proposed Rule 4.33(k) as 4.34(k)) with the exception that the rule is clarified to make explicit that actions involving an FCM or IB brought by a non-United States regulatory agency and involving allegations of fraud or willful misconduct will be considered material. The requirement to disclose actions that would be required to be disclosed in an FCM's or IB's financial statements is being retained. Since FCMs carry funds of the pool or managed account, their financial status and reliability are matters of material importance to prospective investors.

Except for events occurring subsequent to the issuance of the latest certified financial statements, litigation required to be disclosed would already have been disclosed in the FCM's or IB's latest certified financial statements. Generally, the CPO or CTA will be able to rely, under a reasonable diligence standard, upon these pre-existing disclosures as to matters covered by such statements. A CPO should exercise reasonable diligence in determining which subsequent actions are required to be so disclosed. Generally, absent facts placing the CPO or CTA on notice of special circumstances, the CPO or CTA should be able to rely upon representations by the FCM or IB as to what litigation is required to be disclosed in the firm's financial statements.

Actions brought by the Commission are treated differently from those brought by other regulatory agencies due to the presumptively greater relevance of such actions to the investment decision being made. All actions brought by the Commission are considered material other than concluded actions that did not result in civil monetary penalties exceeding $50,000 and did not involve allegations of fraud or other willful misconduct or which were adjudicated on the merits in favor of the specified person. Actions brought by any other federal or state agency, by a non-United States regulatory agency or by a self-regulatory organization, whether domestic or foreign, are material if they involve allegations of fraud or other willful misconduct. In all cases, subject to the general materiality standard, concluded actions resulting in an adjudication on the merits in favor of such persons would not be required to be disclosed.

As in the case of other provisions of the final rules, Rule 4.24(*l*) provides parallel treatment of litigation against CTAs for the pool and the operators of

[173] Proposed Rules 4.24(*l*)(2)(i) and 4.33(k)(2)(i). Under generally accepted accounting principles, certain information regarding litigation must be disclosed if the potential of a financial loss from the litigation is either probable (*i.e.*, likely to occur) or reasonably possible (more than remote but less than likely). *See* ACCOUNTING FOR CONTINGENCIES, Statement of Financial Accounting Standard No. 5, (Financial Accounting Standards Board, 1975) relating to disclosure of contingencies, including litigation.

[174] *See* Rules 4.10(i) and (d)(5), which define the terms ''major commodity trading advisor'' and ''major investee pool.'' Of course, as noted above with respect to conflicts of interest on the part of FCM and IB pricnipals, the requirement to disclose all material information may require disclosure of litigation involving persons not expressly designated in the rules.

investee pools. Subject to the general materiality standard of Rule 4.24(w),[175] disclosure of litigation against non-major CTAs and investee pool operators would not be required by Rule 4.24(*l*). Litigation against the FCM and IB for investee funds, absent special circumstances, would not be required to be disclosed.

8. Principal-Protected Pools: Rule 4.24(o) for CPOs[176]

Proposed Rule 4.24(*o*) would have set forth minimum disclosures relevant to so-called ''guaranteed pools,'' which the Proposing Release termed ''limited risk pools.'' Generally, Proposed Rule 4.24(*o*) would have codified Commission Advisory 86–1[177] by requiring the CPO of a ''limited risk pool'' to describe the nature of the limitation on risk intended to be provided, the manner in which the limitation would be achieved, including the cost of providing it, the conditions to be satisfied in order for participants to receive the benefits of the risk limitation and the circumstances in which the risk limitation would become operative.[178] Proposed Rule 4.24(*o*) would also have required the CPO to include in the break-even analysis required by Rule 4.24(i)(6) disclosure of the cost of establishing and maintaining the risk limitation, expressed as a percentage of the price of a unit of participation in the pool.

The Commission noted in the Proposing Release the proliferation of so-called ''guaranteed pools,'' which are designed to assure participants the return of their initial investment, generally by committing a substantial portion of the assets of the pool to interest-bearing instruments or comparable investments in order to fund the guarantee feature. As noted, such ''guarantee'' structures generally impose costs which limit the potential for return on futures transactions and other types of investment returns, are often subject to significant restrictions, for example, that the participant maintain his investment in the fund for a specified period of years in order to realize on the guarantee, and are subject to the risk of nonfulfillment due to various causes. Consequently, in the past, representations in pool Disclosure Documents concerning various types of guarantee structures have been carefully scrutinized and guidance has been provided by advisory concerning material disclosures that should be made to prospective investors in pools with ''guarantee'' structures.[179] Proposed Rule 4.24(*o*) was designed to codify these specific minimum disclosures concerning ''guarantee'' structures.

The principal comment offered on this provision of the proposed rules was that the term ''limited risk pool'' proposed to be used in Rule 4.24(*o*) was potentially confusing in that most commodity pools are limited partnerships in which the risk to investors is to some degree limited no matter what other measures are taken. A variety of substitute terms were proposed, including ''capital protected pools'' and ''principal return guaranteed pools.'' Other than the comments on the proposed ''limited risk pool'' term, the Commission did not receive any specific comments on proposed Rule 4.24(*o*).

The Commission has determined to substitute the term ''principal-protected pool'' for ''limited risk pool,'' and otherwise to adopt Rule 4.24(*o*) as proposed. As discussed above, ''principal-protected pool'' is defined in Rule 4.10(d)(3) to mean ''a pool (commonly referred to as a ''guaranteed pool'') that is designed to limit the loss of the initial investment of its participants.'' The Commission agrees that use of the ''limited risk'' terminology of the proposal could be confusing to investors and that ''principal-protected'' better distinguishes pools supported by a guarantee feature from those that are not.

As adopted, Rule 4.24(*o*) requires that the CPO describe the nature of the contemplated principal protection feature, disclosing the manner by which protection of principal will be achieved, sources of funding for the protection feature, conditions that must be satisfied for participants to receive the benefits of the protection feature, and when the protection feature becomes operative. The rule also specifies that the costs of purchasing and carrying assets necessary to fund the principal protection feature be included in the break-even analysis required by Rule 4.24(i)(6), expressed as a percentage of the price of a unit of participation. Rule 4.24(*o*) is intended to supersede the specific disclosures set forth in Advisory 86–1. However, Advisory 86–1 may continue to be helpful in constructing disclosures under 4.24(*o*), as well as providing insight into the purposes of this provision. Further, CPOs are reminded of the admonition in Advisory 86–1 that ''(a)ny statements that suggest that the risks of futures trading are decreased by reason of this structure have a high potential to mislead or deceive and could result in serious violations of the Commission's regulations and anti-fraud provisions.''

C. Supplemental and Voluntary Disclosures: Rules 4.24(v) for CPOs and 4.34(n) for CTAs [180]

A frequent complaint concerning commodity pool Disclosure Documents is that in many cases the disclosure process fails to achieve its intended purpose due to the high volume of information, much of which is beyond the scope of Commission requirements, included in the Disclosure Document. To address this concern, the Commission proposed a format for Disclosure Documents under which disclosures that are ''volunteered'' would be required to be placed after all relevant required disclosures. Specifically, proposed Rules 4.24(v) and 4.33(n) would have required all information, other than that required by the Commission,[181] the antifraud provisions of the Act, and any federal or state securities laws and regulations, to be placed ''following the related required disclosures, unless otherwise specified in this rule.'' Additionally, such information could not have been misleading in content or presentation or inconsistent with required disclosures, and it would be subject to the anti-fraud provisions of the Act[182] and the regulations thereunder, and to rules regarding the use of promotional material promulgated by a registered futures association pursuant to section 17(j) of the Act. Essentially, Proposed

[175] Former Rule 4.21(h).

[176] Former Rule 4.21 did not specifically address disclosures relative to principal-protected pools.

This section also discusses Rule 4.10(d)(3), which defines the term ''principal-protected pool.'' *See, also* Rule 4.24(i)(xi), which requires disclosures of costs arising from the guarantee of a principal-protected pool.

[177] (1986–1987 Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶23,035 (April 25, 1986).

[178] Rule 4.24(p), which deals with transferability and redemption, requires a description of restrictions on redemption associated with the pool's investments. The Commission intends that this discussion include a description of any restrictions on transferability and redemption due to use of pool funds to support a guarantee or principal protection feature and of any restrictions upon vesting of such guarantee or principal protection feature.

[179] *See, e.g.*, Advisory 86–1 (1986–1987 Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶23,035 (April 25, 1986), cited previously.

[180] The Commission's former disclosure rules did not specifically address supplemental and voluntary disclosures.

[181] Commission-required disclosures include information required by former Rules 4.21(h) (renumbered as Rule 4.24(w) for CPOs)) and 4.31(g) (renumbered as Rule 4.34(*o*) for CTAs)). As noted above, these rules require CPOs and CTAs to disclose all material information to existing and prospective pool participants and clients even if the information is not specifically required by Commission rules.

[182] *See* sections 4b and 4*o* of the Act.

Rules 4.24(v) and 4.33(n) were designed to assure that core disclosures required under Commission and other rules and statutes are given due prominence and that focus upon these matters is not displaced by the often voluminous material gratuitously included in the Disclosure Document.

The comments received by the Commission indicated significant confusion regarding the meaning and operation of proposed Rules 4.24(v) and 4.33(n). Commenters asserted that it was unclear where various types of voluntary information would be required (or permitted) to be placed. They noted the potential for scattering of related items in different portions of a Disclosure Document, when clarity would be fostered by placing non-required information adjacent to the required information to which it relates. Also, commenters claimed that, in essence, by designating information as ''voluntary,'' registrants would be declaring that such information was not material or important, when in fact such information may be necessary to explain or clarify required disclosures. Commenters also noted that it is often difficult to determine what information is mandated by law or regulation and what is merely advisable to include.

The Commission has adopted Rules 4.24(v) and 4.33(n) (renumbered as 4.34(n)) with the following modifications. The word ''voluntary'' has been replaced in the rule heading with ''supplemental,'' and the rules as adopted distinguish among supplemental performance disclosures (which must be placed after the last required performance disclosure), supplemental information with respect to required non-performance disclosures (which may be placed after or within the text of the corresponding required disclosures), and supplemental information which relates neither to the performance nor the non-performance disclosures required by Commission rules, federal or state laws and regulations, self-regulatory agency regulations or laws of non-United States jurisdictions (which must be placed after the last required disclosure).

As proposed, Rules 4.24(v) and 4.33(n) referred to disclosures required, *inter alia*, by federal or state securities laws or regulations. The modifier ''securities'' has been deleted from the final rules to take account of the potential applicability of other bodies of law. Further, as adopted, the required disclosures from which supplemental information is distinguished by Rules 4.24(v) and 4.34(n) include information required by applicable laws of a non-United States jurisdiction. Rules 4.24(v) and 4.34(n) as adopted, treat supplemental performance and non-performance information differently due to the extensive specific requirements of Commission rules with respect to performance data and the high susceptibility of performance data to use in a misleading manner. Thus, the entire required performance presentation must precede any supplemental performance data.[183] However, required volatility disclosure, for example, supplemental disclosure to indicate high monthly volatility for a CTA whose performance is otherwise required to be provided only on an annual basis, is expressly permitted to be included with the related performance disclosure. Supplemental non-performance information that relates to a disclosure required by Commission rules may be included in the text of or immediately following the related required disclosure, provided that the required disclosure is not thereby obscured or made less prominent. Other supplemental information must follow the last required disclosure, except that proprietary, hypothetical, extracted, pro forma (except as previously discussed)[184] or simulated trading results, because of their inherent lack of reliability and high potential to mislead, must be placed at the end of the Disclosure Document following all other information.[185]

VII. Other Changes

A. Deletion of Negative Disclosures

The Commission proposed to eliminate certain statements which the former rules had required registrants to include if there was no affirmative response to a particular disclosure requirement (*e.g.*, a statement that no material actions had been brought against the CPO in the preceding five years). Although many commenters generally approved of the Commission's efforts to eliminate excessive and burdensome required statements, none of the comments received specifically addressed these proposed changes.

As adopted, the revised disclosure rules thus no longer require CPOs or CTAs to make the following types of statements, as applicable: That there are no actual or potential conflicts of interest regarding any aspect of the pool or trading program on the part of certain persons;[186] that certain persons do not own any beneficial interest in the pool;[187] that there is no minimum or maximum amount of contributions or maximum amount of time pool funds will be held prior to trading;[188] that there are no restrictions on transfer or redemptions of participations;[189] that no material actions have been brought within the past five years against certain persons;[190] and that certain persons will not trade for their own accounts.[191] There remain requirements for affirmative, positive related disclosures on these subjects, as applicable.

B. Use, Amendment and Filing of Disclosure Documents: Rules 4.26 for CPOs and 4.36 for CTAs

As proposed, Rules 4.26 and 4.35, which govern the use, amendment and filing of Disclosure Documents, would have retained, substantially unchanged, the requirements of the former rules, with one exception.[192] The Commission proposed to extend the length of time that a Disclosure Document could have been used following the date thereof from six to nine months. As the Commission noted in the Proposing Release, this would conform the updating requirements of pool Disclosure Documents to those of section 10(a)(3) of the Securities Act for public securities offerings.[193] Thus,

[183] The Commission does not consider footnotes and explanatory text,if any, directly related to a required performance presentation to be supplemental performance disclosures and thus they should be included with the required performance.

[184] *See* discussion in Section V.C.3., *supra*, concerning required pro forma adjustments.

[185] *See* Rules 4.25(a)(8) for CPOs and 4.35(a)(7) for CTAs. The Commission is not specifying the order of presentation as among proprietary, hypothetical, extracted, pro forma or simulated trading results.

[186] *See* former Rules 4.21(a)(3)(iii) and 4.31(a)(5)(iii).

[187] *See* former Rule 4.21(a)(6)(ii).

[188] *See* former Rules 4.21(a)(8)(i)(B), 4.21(a)(8)(ii)(B) and 4.21(a)(8)(iii)(B).

[189] *See* former Rule 4.21(a)(10)(ii)(C)(*2*).

[190] *See* former Rules 4.21(a)(13)(ii) and 4.31(a)(7)(ii).

[191] *See* former Rules 4.21(a)(15)(iii) and 4.31(a)(6)(iii).

[192] Proposed Rule 4.26 would have combined the requirements of former Rules 4.21 (b), (e), (f) and (g), which, respectively, required correction of material inaccuracies or omissions in a Disclosure Document, specified how current the performance and non-performance information must be and how long a Disclosure Document could be used, required attachment of the current Account Statement and Annual Report, and specified the filing requirements for CPO Disclosure Documents. Proposed Rule 4.35 would have combined the requirements of former Rules 4.31 (b), (e) and (f), which, respectively, required correction of material inaccuracies or omissions in a Disclosure Document, specified how current the performance and non-performance information must be and how long a Disclosure Document could be used, and specified the filing requirements for CTA Disclosure Documents.

[193] 59 FR 25351, 25367. Section 10(a)(3) of the Securities Act (15 U.S.C. 77j(a)(3)) requires that when a securities prospectus is used more than nine months after the effective date of the registration statement, information contained therein may not be as of a date more than sixteen

Continued

these rules would have continued to address the currentness of a Disclosure Document and the information therein, corrections, filing and, in the case of CPOs, attachment of the most recent Account Statement and Annual Report to pool Disclosure Documents.

Two commenters questioned whether it was appropriate to adopt a nine-month standard from Securities Act Section 10(a)(3), and recommended instead an annual updating schedule. One commenter objected to maintaining the former rules' requirement to deliver a current Account Statement with the Disclosure Document, contending that in a medium- to long-term investment, monthly account statements are not material and that the requirements to attach the most recent Account Statement to thousands of prospectuses distributed to various branch offices presents substantial compliance problems.[194]

Rules 4.26 and 4.35 are being adopted generally as proposed, with Rule 4.35 renumbered as 4.36. With respect to the comments favoring a one-year updating cycle for Disclosure Documents, the Commission notes that since performance information need only be current as of a date three months prior to the Disclosure Document date, extending the updating requirement to nine months means that the performance information in the Disclosure Document may be as much as a year old. The Commission believes that further extending the updating cycle to twelve months is unwarranted, and that the purpose of the proposed revisions to permit updating on a nine-month cycle, *i.e.*, harmonization with the SEC update cycle, is achieved by adoption of the update provisions as proposed.

The Commission notes that Disclosure Document amendments are not subject to the twenty-one day prefiling requirement, but may be used simultaneously with their filing with the Commission, *i.e.*, not more than twenty-one days after the date on which the CPO or CTA first knows or has reason to know that the Disclosure Document is materially inaccurate or incomplete. In response to a commenter's request for clarification, the Commission also is confirming that an offering memorandum distributed pursuant to Rule 4.12(b) must be updated in the same manner as a Disclosure Document.

In response to the comment concerning the difficulty of, and lack of benefit from, including the current Account Statement with the Disclosure Document, the Commission notes that the information contained in the Account Statement provides a prospective participant with relevant current information, particularly with respect to the pool's performance, that is not available in the Disclosure Document. The requirement to provide the most recent monthly Account Statement is a means of assuring that prospective investors receive recent data concerning the pool's performance. This requirement, coupled with the duty to provide material information to prospective investors, should assure that prospective investors receive timely information concerning the pool's performance as necessary to balance the potentially stale performance data in the Disclosure Document. If it would be misleading not to disclose performance information for the period subsequent to that reflected in the Disclosure Document but prior to the Account Statement, the CPO may be required to provide additional information. In light of the new nine-month update cycle, pool operators should exercise special caution in assuring that sufficient additional information is provided to investors concerning performance volatility occurring subsequent to the period covered in the Disclosure Document. The Commission does not agree with the view expressed by the commenter that monthly data are not material to prospective pool participants. The importance of such current data will in fact be heightened under these rules, given the extension of the update cycle to nine months rather than six months.

The Commission believes that the purpose of the requirement to attach the most recent Account Statement may, however, be accomplished by other methods and has provided in the final rules an alternative procedure to attachment of the Account Statement to the Disclosure Document. Under the alternative procedure, in lieu of attaching the most recent monthly Account Statement to the Disclosure Document, the pool operator would provide performance information for the pool (which may be, but is not required to be, set forth in the form of a monthly Account Statement) current as of a date not more than sixty days prior to the date on which the Disclosure Document is provided to the prospective participant and covering the period since the most recent performance data contained in the Disclosure Document. Of course, any material changes in the pool's performance would require supplementation of the Disclosure Document.

In response to another commenter's request for clarification, the Commission is confirming that a CPO need not (1) file the most current Account Statement for a pool unless it is being used as an amendment to the pool's Disclosure Document; (2) include the most current Account Statement and Annual Report with a Disclosure Document amendment prior to filing such amendment with the Commission; or (3) physically attach the most current Account Statement and Annual Report to a Disclosure Document amendment prior to distributing the amendment to investors—inclusion in the same package is sufficient. When an amendment is distributed to existing pool participants, the CPO need not include the latest Annual Report and Account Statement (provided the existing participants have been receiving such reports on a timely basis). If a Disclosure Document amendment is distributed to previously solicited *prospective* investors, however, the most recent Annual Report and Account Statement must be included.

C. Disclosure Document Delivery Requirements

As proposed, Rules 4.21 and 4.31 would have retained, respectively, only paragraphs (a) and (d) of former Rules 4.21 and 4.31. In each case, paragraph (a) was the requirement for delivery of a Disclosure Document at or before the time of solicitation, and paragraph (d) was the requirement that a signed acknowledgment of receipt of the Disclosure Document be obtained. The requirements specified in former Rules 4.21(a) and (d) and former Rules 4.31(a) and (d) were left intact in the proposed revisions, except that CPOs would have been permitted to use summary offering materials in certain circumstances.

1. Notice of Intended Offering and Term Sheet

Proposed Rule 4.21(a) would have permitted CPOs to provide prospective participants who are accredited

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months prior to such use if the information is known and can be furnished without unreasonable effort or expense.

[194] Another commenter sought guidance (or a safe harbor) with respect to the level of investee pool changes or reallocations which trigger the need to update performance information and/or the Disclosure Document for a fund-of-funds (suggesting a quarterly performance update). *But see* Rule 4.8, which provides specified relief from the pre-filing requirement for CPOs who operate pools of the nature specified therein. Further, as discussed above, whether a given investee pool allocation or reallocation is material depends upon the particular factual circumstances of the pool, including the overall frequency and significance of such changes. Thus, for example, in a dynamically allocated multi-advisor pool with multiple monthly CTA changes, the likelihood of a given CTA change being material is less than in a pool with fewer advisors and less frequent reallocations.

investors as defined in Rule 501 of Regulation D under the Securities Act[195] with a notice of intended offering and term sheet prior to delivery of the Disclosure Document, subject to rules promulgated by a registered futures association pursuant to Section 17(j) of the Act. This provision was intended to facilitate the offering of pools that qualify for relief from registration under the Securities Act as private offerings.

One commenter called the proposed change a worthwhile advance. Most commenters on the proposed provision urged that its coverage be expanded. Two commenters suggested that a CPO should be able to deliver a term sheet to a person who is not an accredited investor, so long as a Disclosure Document was delivered, ultimately or within a ''reasonable time.'' Several commenters urged that CTAs be permitted to use term sheets and notices of intended offerings to solicit accredited investors. Another commenter stated that the proposed amendment to Rule 4.21 would provide no additional relief beyond that already provided by Rule 4.8 and sought both clarification whether a Disclosure Document must still be provided to the recipient of a term sheet and inclusion in the rule itself of the requirement (if any) that the term sheet be filed.

The Commission has determined to adopt Rule 4.21 as proposed. The Commission believes that extending the use of term sheets to non-accredited investors is not appropriate at this time and that such investors should receive the full protection of the disclosure rules to make an informed decision about participating in a pool. The Commission is also declining to permit CTAs to employ a procedure comparable to the use of a notice of intended offering and term sheet. The purpose of allowing the use of this type of short-form solicitation in the case of a pool offering is to permit a simple statement of basic terms to be provided in lieu of an often lengthy pool Disclosure Document. The relative brevity and simplicity of CTA Disclosure Documents do not at this time appear to warrant establishment of a comparable procedure. The Commission confirms that a Disclosure Document must be provided to the recipient of a term sheet and that the term sheet is not required to be filed.

2. Acknowledgment of Disclosure Document

The Commission also sought comment on whether the requirement that CPOs and CTAs must receive from a prospective investor a signed and dated acknowledgment continues to be necessary. Three commenters proposed that, in the case of pools, the requirement be permitted to be satisfied if an acknowledgment is included in the subscription documents, with one such commenter suggesting that such an acknowledgment need not include the date of the Disclosure Document in order to permit use of the subscription documents throughout the offering, asserting that a blank left for the Disclosure Document date would likely be overlooked. The Commission confirms that an acknowledgment may be included in the subscription documents for a pool, provided that the text of the acknowledgment is prominently captioned and distinguished from the subscription agreement and that there is a separate line for the acknowledgment signature and date thereof. The Commission notes that the required provision of a date imposes a minimal burden, if any at all, protects the interests of both the CPO and the participant and is a critical component of the pool's audit trail.

D. Conforming Changes

The Proposing Release contained a number of changes to conform cross-references in the text of various Commission rules to the new section numbering within part 4, which changes are being adopted. The rules so affected are Rules 4.12, 4.21, 4.23, 4.32 (renumbered as 4.33), 30.6 and 150.3. One commenter pointed out that cross references in Rule 4.7 to former Rules 4.21 and 4.31 required amendment to conform with the reorganization and separate designation of certain provisions of former Rules 4.21 and 4.31. The Commission has revised Rule 4.7 accordingly, and has also revised Rule 4.8 to conform cross-references to the revised rule numbers.

VIII. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (''RFA''), 5 U.S.C. 601–611 (1988), requires that agencies, in proposing rules, consider the impact of those rules on small businesses. The rule amendments discussed herein will affect registered CPOs and CTAs. 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.[196] The Commission previously has determined that registered CPOs are not small entities for the purpose of the RFA.[197] 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.[198]

The revised rules reduce rather than increase the requirements of former Rule 4.21 for CPOs and the requirements of former Rule 4.31 for CTAs. The revised rules significantly decrease the amount of past performance and other information required to be disclosed by CPOs and CTAs, and Disclosure Documents may be used for nine months rather than six months. The Commission has adopted in the final revised rules further reductions in disclosure requirements from the proposed revisions (*e.g.*, permitting CTAs to use the new capsule format for presenting the past performance of the offered pool).

In certifying pursuant to section 3(a) of the RFA that the proposed revisions to the part 4 CPO and CTA disclosure rules would not have a significant economic impact on a substantial number of small entities, the Commission invited comments from any CPO or CTA who believed that the proposed revisions, if adopted, would have a significant economic impact on their activities. No such comments were received on the proposed revisions.

Accordingly, pursuant to Rule 3(a) of the RFA (5 U.S.C. 605(b)), the Chairman, on behalf of the Commission, certifies that the action taken herein will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1980, (''PRA'') 44 U.S.C. 3501 *et seq.*, imposes certain requirements on federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the PRA. In compliance with the PRA, the Commission has submitted these proposed rule amendments and the associated information collection requirements to the Office of Management and Budget. The burden associated with this entire collection, including these rules, is as follows:

Average burden hours per response.	124.65

[195] 17 CFR 230.501 (1994).

[196] 47 FR 18618–18621 (April 30, 1982).

[197] 47 FR 18619–18620.

[198] 47 FR 18618–18620.

Number of respondents	3,924
Frequency of response	On occasion

The burden associated with these specific rules, is as follows:

Average burden hours per response.	8.05
Number of respondents	1,162
Frequency of response	On occasion

Copies of the information collection submission to OMB are available from Joe F. Mink, CFTC Clearance officer, 2033 K Street, NW, Washington, DC 20581, (202) 254–9735.

List of Subjects

17 CFR Part 1

Consumer protection, Risk disclosure statements.

17 CFR Part 4

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

17 CFR Part 30

Commodity futures, Consumer protection, Foreign futures and foreign options transactions.

17 CFR Part 150

Commodity futures, Limits on positions.

In consideration of the foregoing, and pursuant to the authority contained in the Commodity Exchange Act, and in particular, sections 2(a)(1), 4b, 4c, 4l, 4m, 4n, 4o, and 8a, 7 U.S.C. 2, 6b, 6c, 6l, 6m, 6n, 6o, and 12a, the Commission hereby amends Chapter I of Title 17 of the Code of Federal Regulations as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

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

Authority: 7 U.S.C. 1a, 2, 2a, 4, 4a, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6*l*, 6m, 6n, 6*o*, 6p, 7, 7a, 7b, 8, 9, 12, 12a, 12c, 13a, 13a–1, 16, 16a, 19, 21, 23 and 24.

2. Section 1.55 is amended by adding paragraph (a)(1)(iii) to read as follows:

§ 1.55 Distribution of ''Risk Disclosure Statement'' by futures commission merchants and introducing brokers.

(a)(1) * * *

(iii) Solely for purposes of this section, a pool operated by a commodity pool operator registered under the Commodity Exchange Act or exempt from such registration need not be treated as a customer.

* * * * *

PART 4—COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

Subpart A—General Provisions, Definitions and Exemptions

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

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

§ 4.7 [Amended]

4. In § 4.7, paragraph (a)(2)(i)(A) is amended by removing the reference ''§ 4.21'' and by adding the reference ''§§ 4.21, 4.24, 4.25 and 4.26'' in its place.

§ 4.7 [Amended]

5. In § 4.7, paragraph (a)(4) is amended by removing the reference ''§§ 4.21, 4.22 or 4.23'' and by adding the reference ''§§ 4.21, 4.22, 4.23, 4.24, 4.25 or 4.26'' in its place.

§ 4.7 [Amended]

6. In § 4.7, paragraph (b)(2)(i)(A) is amended by removing the reference ''§ 4.31'' and by adding the reference ''§§ 4.31, 4.34, 4.35 and 4.36'' in its place.

§ 4.7 [Amended]

7. In § 4.7, paragraph (b)(4) is amended by removing the reference ''§§ 4.31 or 4.32'' and by adding the reference ''§§ 4.31, 4.33, 4.34, 4.35 or 4.36'' in its place.

§ 4.8 [Amended]

8. In § 4.8, the section heading is amended by removing the reference to ''rules 4.21'' and by adding the reference ''rule 4.26'' in its place.

§ 4.8 [Amended]

9. In § 4.8, paragraphs (a) and (b) are amended by removing the reference ''paragraph (g) of § 4.21'' and by adding the reference ''paragraph (d) of § 4.26'' in its place.

10. Section 4.10 is amended by designating paragraph (d) as paragraph (d)(1), by adding new paragraphs (d)(2), (d)(3), (d)(4), (d)(5), (h), (i), (j), (k) and (*l*), and by revising paragraph (e) to read as follows:

§ 4.10 Definitions.

* * * * *

(d)(1) *Pool* means any investment trust, syndicate or similar form of enterprise operated for the purpose of trading commodity interests.

(2) *Multi-advisor pool* means a pool in which:

(i) No commodity trading advisor is allocated or intended to be allocated more than twenty-five percent of the pool's funds available for commodity interest trading; and

(ii) No investee pool is allocated or intended to be allocated more than twenty-five percent of the pool's net asset value.

(3) *Principal-protected pool* means a pool (commonly referred to as a ''guaranteed pool'') that is designed to limit the loss of the initial investment of its participants.

(4) *Investee pool* means any pool in which another pool or account participates or invests, *e.g.*, as a limited partner thereof.

(5) *Major investee pool* means, with respect to a pool, any investee pool that is allocated or intended to be allocated at least ten percent of the net asset value of the pool.

(e)(1) *Principal*, when referring to a person that is a principal of a particular entity, means:

(i) Any person including, but not limited to, a sole proprietor, general partner, officer or director, or person occupying a similar status or performing similar functions, having the power, directly or indirectly, through agreement or otherwise, to exercise a controlling influence over the activities of the entity;

(ii) Any holder or any beneficial owner of ten percent or more of the outstanding shares of any class of stock of the entity; and

(iii) Any person who has contributed ten percent or more of the capital of the entity.

(2) ''Trading principal'' means:

(i) With respect to a commodity pool operator, a principal who participates in making trading decisions for a pool, or who supervises, or has authority to allocate pool assets to, persons so engaged; and

(ii) With respect to a commodity trading advisor, a principal who participates in making trading decisions for the account of a client or who supervises or selects persons so engaged.

* * * * *

(h) *Trading manager* means, with respect to a pool, any person, other than the commodity pool operator of the pool, having sole or partial authority to allocate pool assets to commodity trading advisors or investee pools.

(i) *Major commodity trading advisor* means, with respect to a pool, any commodity trading advisor that is allocated or is intended to be allocated at least ten percent of the pool's funds available for commodity interest trading. For this purpose, the percentage allocation shall be the amount of funds allocated to the trading advisor by

agreement with the commodity pool operator (or trading manager) on behalf of the pool, expressed as a percentage of the lesser of the aggregate value of the assets allocated to the pool's trading advisors or the net assets of the pool at the time of allocation.

(j) *Break-even point:*

(1) Means the trading profit that a pool must realize in the first year of a participant's investment to equal all fees and expenses such that such participant will recoup its initial investment, as calculated pursuant to rules promulgated by a registered futures association pursuant to section 17(j) of the Act; and

(2) Must be expressed both as a dollar amount and as a percentage of the minimum unit of initial investment and assume redemption of the initial investment at the end of the first year of investment.

(k) *Draw-down* means losses experienced by a pool or account over a specified period.

(*l*) *Worst peak-to-valley draw-down* means the greatest cumulative percentage decline in month-end net asset value due to losses sustained by a pool, account or trading program 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.[1] 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 is deemed to have occurred during such five-calendar-year period.

11. Section 4.12 is amended by revising paragraphs (b)(2)(i) and (b)(5)(i) to read as follows:

§ 4.12 Exemption from provisions of part 4.

* * * * *

(b) * * *

(2) * * *

(i) In the case of § 4.21, that the Commission accept in lieu and in satisfaction of the Disclosure Document specified by that section an offering memorandum for the pool which does not contain the information required by §§ 4.24(a), 4.24(b), and 4.24(n); *Provided, however,* that the offering memorandum:

(A) Is prepared pursuant to the requirements of the Securities Act of 1933, as amended, or the exemption from said Act pursuant to which the pool is being offered and sold;

(B) Contains the information required by §§ 4.24(c) through (m) and (o) through (u); and

(C) Complies with the requirements of §§ 4.24(v) and (w).

* * * * *

(5)(i) If a claim of exemption has been made under § 4.12(b)(2)(i), the commodity pool operator must make a statement to that effect on the cover page of each offering memorandum, or amendment thereto, that it is required to file with the Commission pursuant to § 4.26.

* * * * *

Subpart B—Commodity Pool Operators

12. Section 4.21 is revised to read as follows:

§ 4.21 Required delivery of pool Disclosure Document.

(a) No commodity pool operator registered or required to be registered under the Act may, directly or indirectly, solicit, accept or receive funds, securities or other property from a prospective participant in a pool that it operates or that it intends to operate unless, on or before the date it engages in that activity, the commodity pool operator delivers or causes to be delivered to the prospective participant a Disclosure Document for the pool containing the information set forth in § 4.24; *Provided, however,* that where the prospective participant is an accredited investor, as defined in 17 CFR 230.501(a), a notice of intended offering and statement of the terms of the intended offering may be provided prior to delivery of a Disclosure Document, subject to compliance with rules promulgated by a registered futures association pursuant to section 17(j) of the Act.

(b) The commodity pool operator may not accept or receive funds, securities or other property from a prospective participant unless the pool operator first receives from the prospective participant an acknowledgment signed and dated by the prospective participant stating that the prospective participant received a Disclosure Document for the pool.

13. Section 4.23 is amended by revising paragraph (a)(3) to read as follows:

§ 4.23 Recordkeeping.

* * * * *

(a) * * *

(3) The acknowledgement specified by § 4.21(b) for each participant in the pool.

* * * * *

14. Sections 4.24, 4.25 and 4.26 are added to read as follows:

§ 4.24 General disclosures required.

Except as otherwise provided herein, a Disclosure Document must include the following information.

(a) *Cautionary Statement.* The following Cautionary Statement must be prominently displayed on the cover page of the Disclosure Document.

THE COMMODITY FUTURES TRADING COMMISSION HAS NOT PASSED UPON THE MERITS OF PARTICIPATING IN THIS POOL NOR HAS THE COMMISSION PASSED ON THE ADEQUACY OR ACCURACY OF THIS DISCLOSURE DOCUMENT.

(b) *Risk Disclosure Statement.* (1) The following Risk Disclosure Statement must be prominently displayed immediately following any disclosures required to appear on the cover page of the Disclosure Document as provided by the Commission, by any applicable federal or state securities laws and regulations or by any applicable laws of non-United States jurisdictions.

RISK DISCLOSURE STATEMENT

YOU SHOULD CAREFULLY CONSIDER WHETHER YOUR FINANCIAL CONDITION PERMITS YOU TO PARTICIPATE IN A COMMODITY POOL. IN SO DOING, YOU SHOULD BE AWARE THAT FUTURES AND OPTIONS TRADING CAN QUICKLY LEAD TO LARGE LOSSES AS WELL AS GAINS. SUCH TRADING LOSSES CAN SHARPLY REDUCE THE NET ASSET VALUE OF THE POOL AND CONSEQUENTLY THE VALUE OF YOUR INTEREST IN THE POOL. IN ADDITION, RESTRICTIONS ON REDEMPTIONS MAY AFFECT YOUR ABILITY TO WITHDRAW YOUR PARTICIPATION IN THE POOL.

FURTHER, COMMODITY POOLS MAY BE SUBJECT TO SUBSTANTIAL CHARGES FOR MANAGEMENT, AND ADVISORY AND BROKERAGE FEES. IT MAY BE NECESSARY FOR THOSE POOLS THAT ARE SUBJECT TO THESE CHARGES TO MAKE SUBSTANTIAL TRADING PROFITS TO AVOID DEPLETION OR EXHAUSTION OF THEIR ASSETS. THIS DISCLOSURE DOCUMENT CONTAINS A COMPLETE DESCRIPTION OF EACH EXPENSE TO BE CHARGED THIS POOL AT PAGE (insert page number) AND A STATEMENT OF THE PERCENTAGE RETURN NECESSARY TO BREAK EVEN, THAT IS, TO RECOVER THE AMOUNT OF YOUR INITIAL INVESTMENT, AT PAGE (insert page number).

THIS BRIEF STATEMENT CANNOT DISCLOSE ALL THE RISKS AND OTHER FACTORS NECESSARY TO EVALUATE

[1] For example, a worst peak-to-valley draw-down of ''4 to 8–92/25%'' means that the peak-to-valley draw-down lasted from April to August of 1992 and resulted in a twenty-five percent cumulative draw-down.

YOUR PARTICIPATION IN THIS COMMODITY POOL. THEREFORE, BEFORE YOU DECIDE TO PARTICIPATE IN THIS COMMODITY POOL, YOU SHOULD CAREFULLY STUDY THIS DISCLOSURE DOCUMENT, INCLUDING A DESCRIPTION OF THE PRINCIPAL RISK FACTORS OF THIS INVESTMENT, AT PAGE (insert page number).

(2) If the pool may trade foreign futures or options contracts, the Risk Disclosure Statement must further state:

YOU SHOULD ALSO BE AWARE THAT THIS COMMODITY POOL MAY TRADE FOREIGN FUTURES OR OPTIONS CONTRACTS. TRANSACTIONS ON MARKETS LOCATED OUTSIDE THE UNITED STATES, INCLUDING MARKETS FORMALLY LINKED TO A UNITED STATES MARKET, MAY BE SUBJECT TO REGULATIONS WHICH OFFER DIFFERENT OR DIMINISHED PROTECTION TO THE POOL AND ITS PARTICIPANTS. FURTHER, UNITED STATES REGULATORY AUTHORITIES MAY BE UNABLE TO COMPEL THE ENFORCEMENT OF THE RULES OF REGULATORY AUTHORITIES OR MARKETS IN NON-UNITED STATES JURISDICTIONS WHERE TRANSACTIONS FOR THE POOL MAY BE EFFECTED.

(3) If the potential liability of a participant in the pool is greater than the amount of the participant's contribution for the purchase of an interest in the pool and the profits earned thereon, whether distributed or not, the commodity pool operator must make the following additional statement in the Risk Disclosure Statement, to be prominently disclosed as the last paragraph thereof:

ALSO, BEFORE YOU DECIDE TO PARTICIPATE IN THIS POOL, YOU SHOULD NOTE THAT YOUR POTENTIAL LIABILITY AS A PARTICIPANT IN THIS POOL FOR TRADING LOSSES AND OTHER EXPENSES OF THE POOL IS NOT LIMITED TO THE AMOUNT OF YOUR CONTRIBUTION FOR THE PURCHASE OF AN INTEREST IN THE POOL AND ANY PROFITS EARNED THEREON. A COMPLETE DESCRIPTION OF THE LIABILITY OF A PARTICIPANT IN THIS POOL IS EXPLAINED MORE FULLY IN THIS DISCLOSURE DOCUMENT.

(c) *Table of contents.* A table of contents showing, by subject matter, the location of the disclosures made in the Disclosure Document must appear immediately following the Risk Disclosure Statement.

(d) *Information required in the forepart of the Disclosure Document.* (1) The name, address of the main business office, main business telephone number and form of organization of the pool. If the mailing address of the main business office is a post office box number or is not within the United States, its territories or possessions, the pool operator must state where the pool's books and records will be kept and made available for inspection;

(2) The name, address of the main business office, main business telephone number and form of organization of the commodity pool operator. If the mailing address of the main business office is a post office box number or is not within the United States, its territories or possessions, the pool operator must state where its books and records will be kept and made available for inspection;

(3) As applicable, a statement that the pool is:

(i) Privately offered pursuant to section 4(2) of the Securities Act of 1933, as amended (15 U.S.C. 77d(2)), or pursuant to Regulation D thereunder (17 CFR 230.501 *et seq.*);

(ii) A multi-advisor pool as defined in § 4.10(d)(2);

(iii) A principal-protected pool as defined in § 4.10(d)(3); or

(iv) Continuously offered. If the pool is not continuously offered, the closing date of the offering must be disclosed.

(4) The date when the commodity pool operator first intends to use the Disclosure Document; and

(5) The break-even point per unit of initial investment, as specified in § 4.10(j).

(e) *Persons to be identified.* The names of the following persons:

(1) Each principal of the pool operator;

(2) The pool's trading manager, if any, and each principal thereof;

(3) Each major investee pool, the operator of such investee pool, and each principal of the operator thereof;

(4) Each major commodity trading advisor and each principal thereof;

(5) Which of the foregoing persons will make trading decisions for the pool; and

(6) If known, the futures commission merchant through which the pool will execute its trades, and, if applicable, the introducing broker through which the pool will introduce its trades to the futures commission merchant.

(f) *Business background.* (1) The business background, for the five years preceding the date of the Disclosure Document, of:

(i) The commodity pool operator;

(ii) The pool's trading manager, if any;

(iii) Each major commodity trading advisor;

(iv) The operator of each major investee pool; and

(v) Each principal of the foregoing persons who participates in making trading or operational decisions for the pool or who supervises persons so engaged, including, without limitation, the officers and directors of such persons.

(2) The pool operator must include in the description of the business background of each person identified in § 4.24(f)(1) the name and main business of that person's employers, business associations or business ventures and the nature of the duties performed by such person for such employers or in connection with such business associations or business ventures. The location in the Disclosure Document of any required past performance disclosure for such person must be indicated.

(g) *Principal risk factors.* A discussion of the principal risk factors of participation in the offered pool. This discussion must include, without limitation, risks relating to volatility, leverage, liquidity, and counterparty creditworthiness, as applicable to the types of trading programs to be followed, trading structures to be employed and investment activity expected to be engaged in by the offered pool.

(h) *Investment program and use of proceeds.* The pool operator must disclose the following:

(1) The types of commodity interests and other interests which the pool will trade, including:

(i) The approximate percentage of the pool's assets that will be used to trade commodity interests, securities and other types of interests, categorized by type of commodity or market sector, type of security (debt, equity, preferred equity), whether traded or listed on a regulated exchange market, maturity ranges and investment rating, as applicable;

(ii) The extent to which such interests are subject to state or federal regulation, regulation by a non-United States jurisdiction or rules of a self-regulatory organization; (iii)(A) The custodian or other entity (*e.g.*, bank or broker-dealer) which will hold such interests; and

(B) If such interests will be held or if pool assets will be invested in a non-United States jurisdiction, the jurisdiction in which such interests or assets will be held or invested.

(2) A description of the trading and investment programs and policies that will be followed by the offered pool, and any material restrictions or limitations on trading required by the pool's organizational documents or otherwise. This description must include, if applicable, an explanation of the systems used to select commodity trading advisors, investee pools and types of investment activity to which pool assets will be committed;

(3)(i) A summary description of the pool's major commodity trading advisors, including their respective

percentage allocations of pool assets, a description of the nature and operation of the trading programs such advisors will follow, including the types of interests traded pursuant to such programs, and each advisor's historical experience trading such program including material information as to volatility, leverage and rates of return and the length of time during which the advisor has traded such program;

(ii) A summary description of the pool's major investee pools or funds, including their respective percentage allocations of pool assets and a description of the nature and operation of such investee pools and funds, including for each investee pool or fund the types of interests traded, material information as to volatility, leverage and rates of return for such investee pool or fund and the period of its operation; and

(4)(i) The manner in which the pool will fulfill its margin requirements and the approximate percentage of the pool's assets that will be held in segregation pursuant to the Act and the Commission's regulations thereunder;

(ii) If the pool will fulfill its margin requirements with other than cash deposits, the nature of such deposits; and

(iii) If assets deposited by the pool as margin generate income, to whom that income will be paid.

(i) *Fees and expenses.* (1) The Disclosure Document must include a complete description of each fee, commission and other expense which the commodity pool operator knows or should know has been incurred by the pool for its preceding fiscal year and is expected to be incurred by the pool in its current fiscal year, including fees or other expenses incurred in connection with the pool's participation in investee pools and funds.

(2) This description must include, without limitation:

(i) Management fees;

(ii) Brokerage fees and commissions, including interest income paid to futures commission merchants;

(iii) Fees and commissions paid in connection with trading advice provided to the pool;

(iv) Fees and expenses incurred within investments in investee pools, investee funds and other collective investment vehicles, which fees and expenses must be disclosed separately for each investment tier;

(v) Incentive fees;

(vi) Any allocation to the commodity pool operator, or any agreement or understanding which provides the commodity pool operator with the right to receive a distribution, where such allocation or distribution is greater than a pro rata share of the pool's profits based on the percentage of capital contributions made by the commodity pool operator;

(vii) Commissions or other benefits, including trailing commissions paid or that may be paid or accrue, directly or indirectly, to any person in connection with the solicitation of participations in the pool;

(viii) Professional and general administrative fees and expenses, including legal and accounting fees and office supplies expenses;

(ix) Organizational and offering expenses;

(x) Clearance fees and fees paid to national exchanges and self-regulatory organizations;

(xi) For principal-protected pools, any direct or indirect costs to the pool associated with providing the protection feature, as referred to in paragraph (o)(3) of this section; and

(xii) Any other direct or indirect cost.

(3) Where any fee, commission or other expense is determined by reference to a base amount including, but not limited to, ''net assets,'' ''allocation of assets,'' ''gross profits,'' ''net profits,'' or ''net gains,'' the pool operator must explain how such base amount will be calculated, in a manner consistent with calculation of the break-even point.

(4) Where any fee, commission or other expense is based on an increase in the value of the pool, the pool operator must specify how the increase is calculated, the period of time during which the increase is calculated, the fee, commission or other expense to be charged at the end of that period and the value of the pool at which payment of the fee, commission or other expense commences.

(5) Where any fee, commission or other expense of the pool has been paid or is to be paid by a person other than the pool, the pool operator must disclose the nature and amount thereof and the person who paid or who is expected to pay it.

(6) The pool operator must provide, in a tabular format, an analysis setting forth how the break-even point for the pool was calculated. The analysis must include all fees, commissions and other expenses of the pool, as set forth in § 4.24(i)(2).

(j) *Conflicts of interest.* (1) A full description of any actual or potential conflicts of interest regarding any aspect of the pool on the part of:

(i) The commodity pool operator;

(ii) The pool's trading manager, if any;

(iii) Any major commodity trading advisor;

(iv) The commodity pool operator of any major investee pool;

(v) Any principal of the persons described in paragraphs (k)(1) (i), (ii), (iii) and (iv) of this section; and

(vi) Any other person providing services to the pool or soliciting participants for the pool.

(2) Any other material conflict involving the pool.

(3) Included in the description of such conflicts must be any arrangement whereby a person may benefit, directly or indirectly, from the maintenance of the pool's account with the futures commission merchant or from the introduction of the pool's account to a futures commission merchant by an introducing broker (such as payment for order flow or soft dollar arrangements) or from an investment of pool assets in investee pools or funds or other investments.

(k) *Related party transactions.* A full description, including a discussion of the costs thereof to the pool, of any material transactions or arrangements for which there is no publicly disseminated price between the pool and any person affiliated with a person providing services to the pool.

(l) *Litigation.* (1) Subject to the provisions of § 4.24(l)(2), any material administrative, civil or criminal action, whether pending or concluded, within five years preceding the date of the Document, against any of the following persons; *Provided, however,* that a concluded action that resulted in an adjudication on the merits in favor of such person need not be disclosed:

(i) The commodity pool operator, the pool's trading manager, if any, the pool's major commodity trading advisors, and the operators of the pool's major investee pools;

(ii) Any principal of the foregoing; and

(iii) The pool's futures commission merchants and introducing brokers, if any.

(2) With respect to a futures commission merchant or an introducing broker, an action will be considered material if:

(i) The action would be required to be disclosed in the notes to the futures commission merchant's or introducing broker's financial statements prepared pursuant to generally accepted accounting principles;

(ii) The action was brought by the Commission; *Provided, however,* that a concluded action that did not result in civil monetary penalties exceeding $50,000 need not be disclosed unless it involved allegations of fraud or other willful misconduct; or

(iii) The action was brought by any other federal or state regulatory agency, a non-United States regulatory agency or a self-regulatory organization and involved allegations of fraud or other willful misconduct.

(m) *Trading for own account.* If the commodity pool operator, the pool's trading manager, any of the pool's commodity trading advisors or any principal thereof trades or intends to trade commodity interests for its own account, the pool operator must disclose whether participants will be permitted to inspect the records of such person's trades and any written policies related to such trading.

(n) *Performance disclosures.* Past performance must be disclosed as set forth in § 4.25.

(o) *Principal-protected pools.* If the pool is a principal-protected pool as defined in § 4.10(d)(3), the commodity pool operator must:

(1) Describe the nature of the principal protection feature intended to be provided, the manner by which such protection will be achieved, including sources of funding, and what conditions must be satisfied for participants to receive the benefits of such protection;

(2) Specify when the protection feature becomes operative; and

(3) Disclose, in the break-even analysis required by § 4.24(i)(6), the costs of purchasing and carrying the assets to fund the principal protection feature or other limitation on risk, expressed as a percentage of the price of a unit of participation.

(p) *Transferability and redemption.* (1) A complete description of any restrictions upon the transferability of a participant's interest in the pool; and

(2) A complete description of the frequency, timing and manner in which a participant may redeem interests in the pool. Such description must specify:

(i) How the redemption value of a participant's interest will be calculated;

(ii) The conditions under which a participant may redeem its interest, including the cost associated therewith, the terms of any notification required and the time between the request for redemption and payment;

(iii) Any restrictions on the redemption of a participant's interest, including any restrictions associated with the pool's investments; and

(iv) Any liquidity risks relative to the pool's redemption capabilities.

(q) *Liability of pool participants.* The extent to which a participant may be held liable for obligations of the pool in excess of the funds contributed by the participant for the purchase of an interest in the pool.

(r) *Distribution of profits and taxation.* (1) The pool's policies with respect to the payment of distributions from profits or capital and the frequency of such payments;

(2) The federal income tax effects of such payments for a participant, including a discussion of the federal income tax laws applicable to the form of organization of the pool and to such payments therefrom; and

(3) If a pool is specifically structured to accomplish certain federal income tax objectives, the commodity pool operator must explain those objectives, the manner in which they will be achieved and any risks relative thereto.

(s) *Inception of trading and other information.* (1) The minimum aggregate subscriptions that will be necessary for the pool to commence trading commodity interests;

(2) The minimum and maximum aggregate subscriptions that may be contributed to the pool;

(3) The maximum period of time the pool will hold funds prior to the commencement of trading commodity interests;

(4) The disposition of funds received if the pool does not receive the necessary amount to commence trading, including the period of time within which the disposition will be made; and

(5) Where the pool operator will deposit funds received prior to the commencement of trading by the pool, and a statement specifying to whom any income from such deposits will be paid.

(t) *Ownership in pool.* The extent of any ownership or beneficial interest in the pool held by the following:

(1) The commodity pool operator;

(2) The pool's trading manager, if any;

(3) The pool's major commodity trading advisors;

(4) The operators of the pool's major investee pools; and

(5) Any principal of the foregoing.

(u) *Reporting to pool participants.* A statement that the commodity pool operator is required to provide all participants with monthly or quarterly (whichever applies) statements of account and with an annual report containing financial statements certified by an independent public accountant.

(v) *Supplemental information.* If any information, other than that required by Commission rules, the antifraud provisions of the Act, other federal or state laws or regulations, rules of a self-regulatory agency or laws of a non-United States jurisdiction, is provided, such information:

(1) May not be misleading in content or presentation or inconsistent with required disclosures;

(2) Is subject to the antifraud provisions of the Act and Commission rules and to rules regarding the use of promotional material promulgated by a registered futures association pursuant to section 17(j) of the Act; and

(3) Must be placed as follows, unless otherwise specified by Commission rules:

(i) Supplemental performance information (not including proprietary trading results as defined in § 4.25(a)(8), or hypothetical, extracted, pro forma or simulated trading results) must be placed after all specifically required performance information; *Provided, however,* that required volatility disclosure may be included with the related required performance disclosure;

(ii) Supplemental non-performance information relating to a required disclosure may be included with the related required disclosure; and

(iii) Other supplemental information may be included after all required disclosures; *Provided, however,* that any proprietary trading results as defined in § 4.25(a)(8), and any hypothetical, extracted, pro forma or simulated trading results included in the Disclosure Document must appear as the last disclosure therein following all required and non-required disclosures.

(w) *Material information.* Nothing set forth in §§ 4.21, 4.24, 4.25 or § 4.26 shall relieve a commodity pool operator from any obligation under the Act or the regulations thereunder, including the obligation to disclose all material information to existing or prospective pool participants even if the information is not specifically required by such sections.

§ 4.25 Performance disclosures.

(a) *General principles*—(1) *Capsule performance information*—(i) *For pools.* Unless otherwise specified, disclosure of the past performance of a pool must include the following information. Amounts shown must be net of any fees, expenses or allocations to the commodity pool operator.

(A) The name of the pool;

(B) A statement as to whether the pool is:

(*1*) Privately offered pursuant to section 4(2) of the Securities Act of 1933, as amended (15 U.S.C. 77d(2)), or pursuant to Regulation D thereunder (17 CFR 230.501 et seq.);

(*2*) A multi-advisor pool as defined in § 4.10(d)(2); and

(*3*) A principal-protected pool as defined in § 4.10(d)(3);

(C) The date of inception of trading;

(D) The aggregate gross capital subscriptions to the pool;

(E) The pool's current net asset value;

(F) The largest monthly draw-down during the most recent five calendar

years and year-to-date, expressed as a percentage of the pool's net asset value and indicating the month and year of the draw-down (the capsule must include a definition of ''draw-down'' that is consistent with § 4.10(k));

(G) The worst peak-to-valley draw-down during the most recent five calendar years and year-to-date, expressed as a percentage of the pool's net asset value and indicating the months and year of the draw-down; and

(H) Subject to § 4.25(a)(2) for the offered pool, the annual and year-to-date rate of return for the pool for the most recent five calendar years and year-to-date, computed on a compounded monthly basis;

(ii) *For accounts.* Disclosure of the past performance of an account required under this § 4.25 must include the following capsule performance information:

(A) The name of the commodity trading advisor or other person trading the account and the name of the trading program;

(B) The date on which the commodity trading advisor or other person trading the account began trading client accounts and the date when client funds began being traded pursuant to the trading program;

(C) The number of accounts directed by the commodity trading advisor or other person trading the account pursuant to the trading program specified, as of the date of the Disclosure Document;

(D)(*1*) The total assets under the management of the commodity trading advisor or other person trading the account, as of the date of the Disclosure Document; and

(*2*) The total assets traded pursuant to the trading program specified, as of the date of the Disclosure Document;

(E) The largest monthly draw-down for the trading program specified during the most recent five calendar years and year-to-date expressed as a percentage of client funds, and indicating the month and year of the draw-down;

(F) The worst peak-to-valley draw-down for the trading program specified during the most recent five calendar years and year-to-date, expressed as a percentage of net asset value and indicating the months and year of the draw-down; and

(G) The annual and year-to-date rate-of-return for the program specified, computed on a compounded monthly basis.

(2) *Additional requirements with respect to the offered pool.* (i) The performance of the offered pool must be identified as such and separately presented first;

(ii) The rate of return of the offered pool must be presented on a monthly basis for the period specified in § 4.25(a)(5), either in a numerical table or in a bar graph;

(iii) A bar graph used to present monthly rates of return for the offered pool:

(A) Must show percentage rate of return on the vertical axis and one-month increments on the horizontal axis;

(B) Must be scaled in such a way as to clearly show month-to-month differences in rates of return; and

(C) Must separately display numerical percentage annual rates of return for the period covered by the bar graph; and

(iv) The pool operator must make available upon request to prospective and existing participants all supporting data necessary to calculate monthly rates of return for the offered pool as specified in § 4.25(a)(7), for the period specified in § 4.25(a)(5).

(3) *Additional requirements with respect to pools other than the offered pool.* With respect to pools other than the offered pool for which past performance is required to be presented under this section:

(i) Performance data for pools of the same class as the offered pool must be presented following the performance of the offered pool, on a pool-by-pool basis.

(ii) Pools of a different class than the offered pool must be presented less prominently and, unless such presentation would be misleading, may be presented in composite form; *Provided, however,* that:

(A) The Disclosure Document must disclose how the composite was developed;

(B) Pools of different classes or pools with materially different rates of return may not be presented in the same composite.

(iii) For the purpose of § 4.25(a)(3)(ii), the following, without limitation, shall be considered pools of different classes: Pools privately offered pursuant to section 4(2) of the Securities Act of 1933, as amended (15 U.S.C. 77d(2)), or pursuant to Regulation D thereunder (17 CFR 230.501 *et seq.*), and public offerings; and principal-protected and non-principal-protected pools. Multi-advisor pools as defined in § 4.10(d)(2) will be presumed to have materially different rates of return from those of non-multi-advisor pools absent evidence sufficient to demonstrate otherwise.

(iv) Material differences among the pools for which past performance is disclosed, including, without limitation, differences in leverage and use of different trading programs, must be described.

(4) *Additional requirements with respect to accounts.* (i) Unless such presentation would be misleading, past performance of accounts required to be presented under this section may be presented in composite form on a program-by-program basis using the format set forth in § 4.25(a)(1)(ii).

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

(iii) The commodity pool operator must disclose all material differences among accounts included in a composite.

(5) *Time period for required performance.* All required performance information must be presented for the most recent five calendar years and year-to-date or for the life of the pool, account or trading program, if less than five years.

(6) *Trading programs.* If the offered pool will use any of the trading programs for which past performance is required to be presented, the Disclosure Document must so indicate.

(7) *Calculation of, and recordkeeping concerning, performance information.* (i) All performance information presented in a Disclosure Document, including performance information contained in any capsule and performance information not specifically required by Commission rules, must be current as of a date not more than three months preceding the date of the Document, and must be supported by the following amounts, calculated on an accrual basis of accounting in accordance with generally accepted accounting principles, as specified below or by a method otherwise approved by the Commission.

(A) The beginning net asset value for the period, which shall be the same as the previous period's ending net asset value;

(B) All additions, whether voluntary or involuntary, during the period;

(C) All withdrawals and redemptions, whether voluntary or involuntary, during the period;

(D) The net performance for the period, which shall represent the change in the net asset value net of additions, withdrawals, and redemptions;

(E) The ending net asset value for the period, which shall represent the beginning net asset value plus or minus additions, withdrawals, redemptions and net performance;

(F) The rate of return for the period, which shall be calculated by dividing the net performance by the beginning

net asset value or by a method otherwise approved by the Commission; and

(G) The number of units outstanding at the end of the period, if applicable.

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

(8) *Proprietary trading results.* (i) Proprietary trading results may not be included in a Disclosure Document unless such performance is prominently labeled as proprietary and is set forth separately after all disclosures in accordance with § 4.24(v), together with a discussion of any differences between such performance and the performance of the offered pool, including, but not limited to, differences in costs, leverage and trading methodology.

(ii) For the purposes of § 4.24(v) and this § 4.25(a), proprietary trading results means the performance of any pool or account in which fifty percent or more of the beneficial interest is owned or controlled by:

(A) The commodity pool operator, trading manager (if any), commodity trading advisor or any principal thereof

(B) An affiliate or family member of the commodity pool operator, trading manager (if any) or commodity trading advisor; or

(C) Any person providing services to the pool.

(9) *Required legend.* Any past performance presentation, whether or not required by Commission rules, must be preceded by the following statement, prominently displayed:

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

(b) *Performance disclosure when the offered pool has at least a three-year operating history.* The commodity pool operator must disclose the performance of the offered pool, in accordance with paragraphs (a)(1)(i) (A) through (H) and (a)(2) of this § 4.25, where:

(1) The offered pool has traded commodity interests for three years or more; and

(2) For at least such three-year period, seventy-five percent or more of the contributions to the pool were made by persons unaffiliated with the commodity pool operator, the trading manager (if any), the pool's commodity trading advisors, or the principals of any of the foregoing.

(c) *Performance disclosure when the offered pool has less than a three-year operating history.*—(1) *Offered pool performance.* (i) The commodity pool operator must disclose the performance of the offered pool, in accordance with paragraphs (a)(1)(i)(A) through (H) and (a)(2) of this § 4.25; or

(ii) If the offered pool has no operating history, the pool operator must prominently display the following statement:

THIS POOL HAS NOT COMMENCED TRADING AND DOES NOT HAVE ANY PERFORMANCE HISTORY.

(2) *Other performance of commodity pool operator.* (i)(A) Except as provided in § 4.25(a)(8), the commodity pool operator must disclose, for the period specified by § 4.25(a)(5), the performance of each other pool operated by the pool operator (and by the trading manager if the offered pool has a trading manager) in accordance with paragraphs (a)(1)(i) (C) through (H) and (a)(3) of this § 4.25, and the performance of each other account traded by the pool operator (and by the trading manager if the offered pool has a trading manager) in accordance with paragraphs (a)(1)(ii) (C) through (G) of this § 4.25. If the trading manager has been delegated complete authority for the offered pool's trading, and the trading manager's performance is not materially different from that of the pool operator, the performance of the other pools operated by and accounts traded by the pool operator is not required to be disclosed.

(B) In addition, if the pool operator, or if applicable, the trading manager, has not operated for at least three years any commodity pool in which seventy-five percent or more of the contributions to the pool were made by persons unaffiliated with the commodity pool operator, the trading manager, the pool's commodity trading advisors or their respective principals, the pool operator must also disclose the performance of each other pool operated by and account traded by the trading principals of the pool operator (and of the trading manager, as applicable) unless such performance does not differ in any material respect from the performance of the offered pool and the pool operator (and trading manager, if any) disclosed in the Disclosure Document.

(ii) If neither the pool operator or trading manager (if any), nor any of its trading principals has operated any other pools or traded any other accounts, the pool operator must prominently display the following statement: NEITHER THIS POOL OPERATOR (TRADING MANAGER, IF APPLICABLE) NOR ANY OF ITS TRADING PRINCIPALS HAS PREVIOUSLY OPERATED ANY OTHER POOLS OR TRADED ANY OTHER ACCOUNTS. If the commodity pool operator or trading manager, if applicable, is a sole proprietorship, reference to its trading principals may be deleted from the prescribed statement.

(3) *Major commodity trading advisor performance.* (i) The commodity pool operator must disclose the performance of any accounts (including pools) directed by a major commodity trading advisor in accordance with paragraphs (a)(1)(ii) (C) through (G) of this § 4.25.

(ii) If a major commodity trading advisor has not previously traded accounts, the pool operator must prominently display the following statement:

(name of the major commodity trading advisor), A COMMODITY TRADING ADVISOR THAT HAS DISCRETIONARY TRADING AUTHORITY OVER (percentage of the pool's funds available for commodity interest trading allocated to that trading advisor) PERCENT OF THE POOL'S FUTURES AND COMMODITY OPTION TRADING HAS NOT PREVIOUSLY DIRECTED ANY ACCOUNTS.

(4) *Major investee pool performance.* (i) The commodity pool operator must disclose the performance of any major investee pool.

(ii) If a major investee pool has not commenced trading, the pool operator must prominently display the following statement:

(name of the major investee pool), AN INVESTEE POOL THAT IS ALLOCATED (percentage of the pool assets allocated to that investee pool) PERCENT OF THE POOL'S ASSETS HAS NOT COMMENCED TRADING.

(5) *Other commodity trading advisor and investee pool performance.* With respect to commodity trading advisors and investee pools for which performance is not required to be disclosed pursuant to this § 4.25(c) (3) and (4), the pool operator must provide a summary description of the performance history of each of such advisors and pools, including:

(i) Monthly return parameters (highs and lows);

(ii) Historical volatility and degree of leverage; and

(iii) Any material differences between the performance of such advisors and pools as compared to that of the offered pool's major trading advisors and major investee pools.

§ 4.26 Use, amendment and filing of Disclosure Document.

(a)(1) Subject to paragraph (c) of this section, all information contained in the Disclosure Document must be current as of the date of the Document; *Provided, however,* that performance information may be current as of a date not more than three months prior to the date of the Document.

(2) No commodity pool operator may use a Disclosure Document dated more

than nine months prior to the date of its use.

(b) The commodity pool operator must attach to the Disclosure Document the most current Account Statement and Annual Report for the pool required to be distributed in accordance with § 4.22; *Provided, however,* that in lieu of the most current Account Statement the commodity pool operator may provide performance information for the pool current as of a date not more than sixty days prior to the date on which the Disclosure Document is distributed and covering the period since the most recent performance information contained in the Disclosure Document.

(c) (1) If the commodity pool operator knows or should know that the Disclosure Document is materially inaccurate or incomplete in any respect, it must correct that defect and must distribute the correction to:

(i) All existing pool participants within 21 calendar days of the date upon which the pool operator first knows or has reason to know of the defect; and

(ii) Each previously solicited prospective pool participant prior to accepting or receiving funds, securities or other property from any such prospective participant. The pool operator may furnish the correction by way of an amended Disclosure Document, a sticker on the Document, or other similar means.

(2) The pool operator may not use the Disclosure Document until such correction has been made.

(d) Except as provided by § 4.8:

(1) The commodity pool operator must file with the Commission two copies of the Disclosure Document for each pool that it operates or that it intends to operate not less than 21 calendar days prior to the date the pool operator first intends to deliver the Document to a prospective participant in the pool; and

(2) The commodity pool operator must file with the Commission two copies of all subsequent amendments to the Disclosure Document for each pool that it operates or that it intends to operate within 21 calendar days of the date upon which the pool operator first knows or has reason to know of the defect requiring the amendment.

Subpart C—Commodity Trading Advisors

15. Section 4.31 is revised to read as follows:

§ 4.31 Required delivery of Disclosure Document to prospective clients.

(a) No commodity trading advisor registered or required to be registered under the Act may solicit a prospective client, or enter into an agreement with a prospective client to direct the client's commodity interest account or to guide the client's commodity interest trading by means of a systematic program that recommends specific transactions, unless the commodity trading advisor, at or before the time it engages in the solicitation or enters into the agreement (whichever is earlier), delivers or causes to be delivered to the prospective client a Disclosure Document for the trading program pursuant to which the trading advisor seeks to direct the client's account or to guide the client's trading, containing the information set forth in §§ 4.34 and 4.35.

(b) The commodity trading advisor may not enter into an agreement with a prospective client to direct the client's commodity interest account or to guide the client's commodity interest trading unless the trading advisor first receives from the prospective client an acknowledgment signed and dated by the prospective client stating that the client received a Disclosure Document for the trading program pursuant to which the trading advisor will direct his account or will guide his trading.

16. Section 4.32 is redesignated Section 4.33, and amended by revising paragraph (a)(2) to read as follows:

§ 4.33 Recordkeeping.

* * * * *

(a) * * *

(2) The acknowledgement specified in § 4.31(b).

* * * * *

§ 4.32 [Reserved]

17. Section 4.32 is added and reserved.

18. Sections 4.34, 4.35 and 4.36 are added to read as follows:

§ 4.34 General disclosures required.

Except as otherwise provided herein, a Disclosure Document must include the following information.

(a) *Cautionary Statement.* The following Cautionary Statement must be prominently displayed on the cover page of the Disclosure Document:

THE COMMODITY FUTURES TRADING COMMISSION HAS NOT PASSED UPON THE MERITS OF PARTICIPATING IN THIS TRADING PROGRAM NOR HAS THE COMMISSION PASSED ON THE ADEQUACY OR ACCURACY OF THIS DISCLOSURE DOCUMENT.

(b) *Risk Disclosure Statement.* (1) The following Risk Disclosure Statement must be prominently displayed immediately following any disclosures required to appear on the cover page of the Disclosure Document as provided by the Commission, by any applicable federal or state securities laws and regulations or by any applicable laws of non-United States jurisdictions:

RISK DISCLOSURE STATEMENT

THE RISK OF LOSS IN TRADING COMMODITIES CAN BE SUBSTANTIAL. YOU SHOULD THEREFORE CAREFULLY CONSIDER WHETHER SUCH TRADING IS SUITABLE FOR YOU IN LIGHT OF YOUR FINANCIAL CONDITION. IN CONSIDERING WHETHER TO TRADE OR TO AUTHORIZE SOMEONE ELSE TO TRADE FOR YOU, YOU SHOULD BE AWARE OF THE FOLLOWING:

IF YOU PURCHASE A COMMODITY OPTION YOU MAY SUSTAIN A TOTAL LOSS OF THE PREMIUM AND OF ALL TRANSACTION COSTS.

IF YOU PURCHASE OR SELL A COMMODITY FUTURE OR SELL A COMMODITY OPTION YOU MAY SUSTAIN A TOTAL LOSS OF THE INITIAL MARGIN FUNDS AND ANY ADDITIONAL FUNDS THAT YOU DEPOSIT WITH YOUR BROKER TO ESTABLISH OR MAINTAIN YOUR POSITION. IF THE MARKET MOVES AGAINST YOUR POSITION, YOU MAY BE CALLED UPON BY YOUR BROKER TO DEPOSIT A SUBSTANTIAL AMOUNT OF ADDITIONAL MARGIN FUNDS, ON SHORT NOTICE, IN ORDER TO MAINTAIN YOUR POSITION. IF YOU DO NOT PROVIDE THE REQUESTED FUNDS WITHIN THE PRESCRIBED TIME, YOUR POSITION MAY BE LIQUIDATED AT A LOSS, AND YOU WILL BE LIABLE FOR ANY RESULTING DEFICIT IN YOUR ACCOUNT.

UNDER CERTAIN MARKET CONDITIONS, YOU MAY FIND IT DIFFICULT OR IMPOSSIBLE TO LIQUIDATE A POSITION. THIS CAN OCCUR, FOR EXAMPLE, WHEN THE MARKET MAKES A ''LIMIT MOVE.''

THE PLACEMENT OF CONTINGENT ORDERS BY YOU OR YOUR TRADING ADVISOR, SUCH AS A ''STOP-LOSS'' OR ''STOP-LIMIT'' ORDER, WILL NOT NECESSARILY LIMIT YOUR LOSSES TO THE INTENDED AMOUNTS, SINCE MARKET CONDITIONS MAY MAKE IT IMPOSSIBLE TO EXECUTE SUCH ORDERS.

A ''SPREAD'' POSITION MAY NOT BE LESS RISKY THAN A SIMPLE ''LONG'' OR ''SHORT'' POSITION.

THE HIGH DEGREE OF LEVERAGE THAT IS OFTEN OBTAINABLE IN COMMODITY TRADING CAN WORK AGAINST YOU AS WELL AS FOR YOU. THE USE OF LEVERAGE CAN LEAD TO LARGE LOSSES AS WELL AS GAINS.

IN SOME CASES, MANAGED COMMODITY ACCOUNTS ARE SUBJECT TO SUBSTANTIAL CHARGES FOR MANAGEMENT AND ADVISORY FEES. IT MAY BE NECESSARY FOR THOSE ACCOUNTS THAT ARE SUBJECT TO THESE CHARGES TO MAKE SUBSTANTIAL TRADING PROFITS TO AVOID DEPLETION OR EXHAUSTION OF THEIR ASSETS. THIS DISCLOSURE DOCUMENT CONTAINS, AT PAGE (insert page number), A COMPLETE DESCRIPTION OF EACH FEE TO BE CHARGED TO YOUR ACCOUNT BY THE COMMODITY TRADING ADVISOR.

THIS BRIEF STATEMENT CANNOT DISCLOSE ALL THE RISKS AND OTHER

SIGNIFICANT ASPECTS OF THE COMMODITY MARKETS. YOU SHOULD THEREFORE CAREFULLY STUDY THIS DISCLOSURE DOCUMENT AND COMMODITY TRADING BEFORE YOU TRADE, INCLUDING THE DESCRIPTION OF THE PRINCIPAL RISK FACTORS OF THIS INVESTMENT, AT PAGE (insert page number).

(2) If the commodity trading advisor may trade foreign futures or options contracts pursuant to the offered trading program, the Risk Disclosure Statement must further state the following:

YOU SHOULD ALSO BE AWARE THAT THIS COMMODITY TRADING ADVISOR MAY ENGAGE IN TRADING FOREIGN FUTURES OR OPTIONS CONTRACTS. TRANSACTIONS ON MARKETS LOCATED OUTSIDE THE UNITED STATES, INCLUDING MARKETS FORMALLY LINKED TO A UNITED STATES MARKET MAY BE SUBJECT TO REGULATIONS WHICH OFFER DIFFERENT OR DIMINISHED PROTECTION. FURTHER, UNITED STATES REGULATORY AUTHORITIES MAY BE UNABLE TO COMPEL THE ENFORCEMENT OF THE RULES OF REGULATORY AUTHORITIES OR MARKETS IN NON-UNITED STATES JURISDICTIONS WHERE YOUR TRANSACTIONS MAY BE EFFECTED. BEFORE YOU TRADE YOU SHOULD INQUIRE ABOUT ANY RULES RELEVANT TO YOUR PARTICULAR CONTEMPLATED TRANSACTIONS AND ASK THE FIRM WITH WHICH YOU INTEND TO TRADE FOR DETAILS ABOUT THE TYPES OF REDRESS AVAILABLE IN BOTH YOUR LOCAL AND OTHER RELEVANT JURISDICTIONS.

(3) If the commodity trading advisor is not also a registered futures commission merchant, the trading advisor must make the additional following statement in the Risk Disclosure Statement, to be included as the last paragraph thereof:

THIS COMMODITY TRADING ADVISOR IS PROHIBITED BY LAW FROM ACCEPTING FUNDS IN THE TRADING ADVISOR'S NAME FROM A CLIENT FOR TRADING COMMODITY INTERESTS. YOU MUST PLACE ALL FUNDS FOR TRADING IN THIS TRADING PROGRAM DIRECTLY WITH A FUTURES COMMISSION MERCHANT.

(c) *Table of contents.* A table of contents showing, by subject matter, the location of the disclosures made in the Disclosure Document, must appear immediately following the Risk Disclosure Statement.

(d) *Information required in the forepart of the Disclosure Document.* (1) The name, address of the main business office, main business telephone number and form of organization of the commodity trading advisor. If the mailing address of the main business office is a post office box number or is not within the United States, its territories or possessions, the trading advisor must state where its books and records will be kept and made available for inspection; and

(2) The date when the commodity trading advisor first intends to use the Disclosure Document.

(e) *Persons to be identified.* The names of the following persons:

(1) Each principal of the trading advisor;

(2) The futures commission merchant with which the commodity trading advisor will require the client to maintain its account or, if the client is free to choose the futures commission merchant with which it will maintain its account, the trading advisor must make a statement to that effect; and

(3) The introducing broker through which the commodity trading advisor will require the client to introduce its account or, if the client is free to choose the introducing broker through which it will introduce its account, the trading advisor must make a statement to that effect.

(f) *Business background.* (1) The business background, for the five years preceding the date of the Disclosure Document, of:

(i) The commodity trading advisor; and

(ii) Each principal of the trading advisor who participates in making trading or operational decisions for the trading advisor or supervises persons so engaged, including, without limitation, the trading advisor's officers and directors.

(2) The trading advisor must include in the description of the business background of each person identified in § 4.34(f)(1) the name and main business of that person's employers, business associations or business ventures and the nature of the duties performed by such person for such employers or in connection with such business associations or business ventures. The location in the Disclosure Document of any required past performance disclosure for such person must be indicated.

(g) *Principal risk factors.* A discussion of the principal risk factors of this trading program. This discussion must include, without limitation, risks due to volatility, leverage, liquidity, and counterparty creditworthiness, as applicable to the trading program and the types of transactions and investment activity expected to be engaged in pursuant to such program.

(h) *Trading program.* A description of the trading program, which must include the types of commodity interests and other interests the commodity trading advisor intends to trade, with a description of any restrictions or limitations on such trading established by the trading advisor or otherwise.

(i) *Fees.* A complete description of each fee which the commodity trading advisor will charge the client.

(1) Wherever possible, the trading advisor must specify the dollar amount of each such fee.

(2) Where any fee is determined by reference to a base amount including, but not limited to, ''net assets,'' ''gross profits,'' ''net profits'' or ''net gains,'' the trading advisor must explain how such base amount will be calculated.

(3) Where any fee is based on an increase in the value of the client's commodity interest account, the trading advisor must specify how that increase is calculated, the period of time during which the increase is calculated, the fee to be charged at the end of that period and the value of the account at which payment of the fee commences.

(j) *Conflicts of interest.* (1) A full description of any actual or potential conflicts of interest regarding any aspect of the trading program on the part of:

(i) The commodity trading advisor;

(ii) Any futures commission merchant with which the client will be required to maintain its commodity interest account;

(iii) Any introducing broker through which the client will be required to introduce its account to a futures commission merchant; and

(iv) Any principal of the foregoing.

(2) Any other material conflict involving any aspect of the offered trading program.

(3) Included in the description of any such conflict must be any arrangement whereby the trading advisor or any principal thereof may benefit, directly or indirectly, from the maintenance of the client's commodity interest account with a futures commission merchant or the introduction of such account through an introducing broker (such as payment for order flow or soft dollar arrangements).

(k) *Litigation.* (1) Subject to the provisions of § 4.34(k)(2), any material administrative, civil or criminal action, whether pending or concluded, within five years preceding the date of the Document, against any of the following persons; *Provided, however,* that a concluded action that resulted in an adjudication on the merits in favor of such person need not be disclosed:

(i) The commodity trading advisor and any principal thereof:

(ii) Any futures commission merchant with which the client will be required

to maintain its commodity interest account; and

(iii) Any introducing broker through which the client will be required to introduce its account to the futures commission merchant.

(2) With respect to a futures commission merchant or an introducing broker, an action will be considered material if:

(i) The action would be required to be disclosed in the notes to the futures commission merchant's or introducing broker's financial statements prepared pursuant to generally accepted accounting principles;

(ii) The action was brought by the Commission; *Provided, however,* that a concluded action that did not result in civil monetary penalties exceeding $50,000 need not be disclosed unless it involved allegations of fraud or other willful misconduct; or

(iii) The action was brought by any other federal or state regulatory agency, a non-United States regulatory agency or a self-regulatory organization and involved allegations of fraud or other willful misconduct.

(*l*) *Trading for own account.* If the commodity trading advisor or any principal thereof trades or intends to trade commodity interests for its own account, the trading advisor must disclose whether clients will be permitted to inspect the records of such person's trading and any written policies related to such trading.

(m) *Performance disclosures.* Past performance must be disclosed as set forth in § 4.35.

(n) *Supplemental information.* If any information, other than that required by Commission rules, the antifraud provisions of the Act, other federal or state laws and regulations, any rules of a self-regulatory agency or laws of a non-United States jurisdiction, is provided, such information:

(1) May not be misleading in content or presentation or inconsistent with the required disclosures;

(2) Is subject to the antifraud provisions of the Act and Commission rules, and to rules regarding the use of promotional material promulgated by a registered futures association pursuant to section 17(j) of the Act; and

(3) Must be placed as follows, unless otherwise specified by Commission rules:

(i) Supplemental performance information (not including proprietary trading results as defined in § 4.35(a)(7), or hypothetical, extracted, pro forma or simulated trading results) must be placed after all required performance information;

(ii) Supplemental non-performance information relating to a required disclosure may be included with the related required disclosure; and

(iii) Other supplemental information may be included after all required disclosures; *Provided, however,* That any proprietary trading results as defined in § 4.35(a)(7), and any hypothetical, extracted, pro forma or simulated trading results included in the Disclosure Document must appear as the last disclosure therein following all required and non-required disclosures.

(*o*) *Material information.* Nothing set forth in §§ 4.31, 4.34, 4.35 or § 4.36 shall relieve a commodity trading advisor from any obligation under the Act or the regulations thereunder, including the obligation to disclose all material information to existing or prospective clients even if the information is not specifically required by such sections.

§ 4.35 Performance disclosures.

(a) *General principles.*—(1) *Capsule performance information.* Unless otherwise specified, disclosure of the past performance of an account or trading program required under this § 4.35 must include the following information:

(i) The name of the commodity trading advisor or other person trading the account and the name of the trading program;

(ii) The date on which the commodity trading advisor or other person trading the account began trading client accounts and the date when client funds began being traded pursuant to the trading program;

(iii) The number of accounts directed by the trading advisor or other person trading the account pursuant to the trading program specified, as of the date of the Disclosure Document;

(iv)(A) The total assets under the management of the trading advisor or other person trading the account, as of the date of the Disclosure Document; and

(B) The total assets traded pursuant to the trading program specified, as of the date of the Disclosure Document;

(v) The largest monthly draw-down for the account or trading program specified during the most recent five calendar year and year-to-date expressed as a percentage of client funds and indicating the month and year of the draw-down (the capsule must include a definition of ''draw-down'' that is consistent with § 4.10(k));

(vi) The worst peak-to-valley draw-down for the trading program specified during the most recent five calendar year and year-to-date, expressed as a percentage of net asset value and indicating the months and year 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 the five most recent calendar years and year-to-date, computed on a compounded monthly basis; *Provided, however,* That performance of the offered trading program must include monthly rates of return for such period; and

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

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

(B) The number of accounts traded pursuant to the offered trading program that were closed during the period specified in § 4.35(a)(5) with negative net performance (losses) as of the date the account was closed.

(2) *Additional requirements with respect to the offered trading program.* (i) The performance of the offered trading program must be identified as such and separately presented first;

(ii) The rate of return of the offered trading program must be presented on a monthly basis for the period specified in § 4.35(a)(5), either in a numerical table or in a bar graph;

(iii) A bar graph used to present monthly rates of return for the offered trading program:

(A) Must show percentage rate of return on the vertical axis and one-month increments on the horizontal axis;

(B) Must be scaled in such a way as to clearly show month-to-month differences in rates of return; and

(C) Must separately display numerical percentage annual rates of return for the period covered by the bar graph; and

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

(3) *Composite presentation.* (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, using the format set forth in § 4.35(a)(1).

(ii) Accounts that differ materially with respect to rates 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.

(4) *Current information.* All performance information presented in the Disclosure Document must be current as of a date not more than three months preceding the date of the Document.

(5) *Time period for required performance.* All required performance information must be presented for the most recent five calendar years and year-to-date or for the life of the trading program or account, if less than five years.

(6) *Calculation of, and recordkeeping concerning, performance information.* (i) All performance information presented in a Disclosure Document, including performance information contained in any capsule and performance information not specifically required by Commission rules, must be current as of a date not more than three months preceding the date of the Document, and must be supported by the following amounts, calculated on an accrual basis of accounting in accordance with generally accepted accounting principles, as specified below or by a method otherwise approved by the Commission.

(A) The beginning net asset value for the period, which shall represent the previous period's ending net asset value;

(B) All additions, whether voluntary or involuntary, during the period;

(C) All withdrawals and redemptions, whether voluntary or involuntary, during the period;

(D) The net performance for the period, which shall represent the change in the net asset value net of additions, withdrawals, redemptions, fees and expenses;

(E) The ending net asset value for the period, which shall represent the beginning net asset value plus or minus additions, withdrawals and redemptions, and net performance; and

(F) The rate of return for the period, computed on a compounded monthly basis, which shall be calculated by dividing the net performance by the beginning net asset value.

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

(7) *Proprietary trading results.* (i) Proprietary trading results shall not be included in a Disclosure Document unless such performance is prominently labeled as proprietary and is set forth separately after all disclosures in accordance with § 4.34(n), together with a discussion of any differences between such performance and the performance of the offered trading program, including, but not limited to, differences in costs, leverage and trading.

(ii) For the purposes of § 4.34(n) and this § 4.35(a), proprietary trading results means the performance of any account in which fifty percent or more of the beneficial interest is owned or controlled by:

(A) The commodity trading advisor or any of its principals;

(B) An affiliate or family member of the commodity trading advisor; or

(C) Any person providing services to the account.

(8) *Required legend.* Any past performance presentation, whether or not required by Commission rules, must be preceded with the following statement, prominently displayed:

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

(b) *Performance to be disclosed.* Except as provided in § 4.35(a)(7), the commodity trading advisor must disclose the actual performance of all accounts directed by the commodity trading advisor and by each of its trading principals; *Provided, however,* that if the trading advisor or its trading principals previously have not directed any accounts, the trading advisor must prominently disclose this fact with one of the following statements, as applicable:

(1) THIS TRADING ADVISOR PREVIOUSLY HAS NOT DIRECTED ANY ACCOUNTS; or

(2) NONE OF THE TRADING PRINCIPALS OF THIS TRADING ADVISOR HAS PREVIOUSLY DIRECTED ANY ACCOUNTS; or

(3) NEITHER THIS TRADING ADVISOR NOR ANY OF ITS TRADING PRINCIPALS HAVE PREVIOUSLY DIRECTED ANY ACCOUNTS. If the commodity trading advisor is a sole proprietorship, reference to its trading principals need not be included in the prescribed statement.

§ 4.36 Use, amendment and filing of Disclosure Document.

(a) Subject to paragraph (c) of this section, all information contained in the Disclosure Document must be current as of the date of the Document; *Provided, however,* that performance information must be current as of a date not more than three months preceding the date of the Document.

(b) No commodity trading advisor may use a Disclosure Document dated more than nine months prior to the date of its use.

(c)(1) If the commodity trading advisor knows or should know that the Disclosure Document is materially inaccurate or incomplete in any respect, it must correct that defect and must distribute the correction to:

(i) All existing clients in the trading program within 21 calendar days of the date upon which the trading advisor first knows or has reason to know of the defect; and

(ii) Each previously solicited prospective client for the trading program prior to entering into an agreement to direct or to guide such prospective client's commodity interest account pursuant to the program. The trading advisor may furnish the correction by way of an amended Disclosure Document, a sticker on the Document, or other similar means.

(2) The trading advisor may not use the Disclosure Document until such correction is made.

(d) (1) The trading advisor must file with the Commission two copies of the Disclosure Document for each trading program that it offers or that it intends to offer not less than 21 calendar days prior to the date the trading advisor first intends to deliver the Document to a prospective client in the trading program.

(2) The commodity trading advisor must file with the Commission two copies of all subsequent amendments to the Disclosure Document for each trading program that it offers or that it intends to offer within 21 calendar days of the date upon which the trading advisor first knows or has reason to know of the defect requiring the amendment.

Subpart D—Advertising

19. Section 4.41 is amended by revising paragraph (b)(1) to read as follows:

§ 4.41 Advertising by commodity pool operators, commodity trading advisors, and the principals thereof.

* * * * *

(b) (1) No person may present the performance of any simulated or hypothetical commodity interest account, transaction in a commodity interest or series of transactions in a commodity interest of a commodity pool operator, commodity trading advisor, or any principal thereof, unless such performance is accompanied by one of the following:

(i) The following statement: ''Hypothetical or simulated performance results have certain inherent limitations. Unlike an actual performance record, simulated results do not represent actual trading. Also, since the trades have not actually been executed, the results may have under- or over-

compensated for the impact, if any, of certain market factors, such as lack of liquidity. Simulated 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 those shown;'' or

(ii) A statement prescribed pursuant to rules promulgated by a registered futures association pursuant to section 17(j) of the Act.

* * * * *

PART 30—FOREIGN FUTURES AND FOREIGN OPTIONS TRANSACTIONS

20. The authority citation for part 30 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 4, 6, 6c, and 12a.

21. Section 30.6 is amended by revising paragraphs (b)(1) and (b)(2) to read as follows:

§ 30.6 Disclosure.

* * * * *

(b) *Commodity pool operators and commodity trading advisors.* (1) No commodity pool operator registered or required to be registered under this part, or exempt from registration pursuant to § 30.5 of this part, may, directly or indirectly, solicit, accept or receive funds, securities or other property from a prospective participant in a foreign pool that it operates or that it intends to operate or, in the case of a commodity trading advisor, no commodity trading advisor registered or required to be registered under this part, or exempt from registration pursuant to § 30.5 of this part, may solicit or enter into an agreement with a prospective client to direct or to guide the client's foreign commodity interest trading by means of a systematic program that recommends specific transactions, unless the commodity pool operator or commodity trading advisor, at or before the time it engages in such activities, first provides each prospective participant or client with the Risk Disclosure Statement set forth in § 4.24(b) in the case of a commodity pool operator or § 4.34(b) in the case of a commodity trading advisor.

(2) The disclosure statement required to be provided in paragraph (b)(1) of this section may be given as a separate document or, if part of the Disclosure Document required to be furnished customers or potential customers pursuant to § 4.21 or § 4.31 of this chapter, must be prominently disclosed immediately following any disclosures required to appear on the cover page of the Disclosure Document as provided by the Commission or any applicable federal or state securities laws and regulations.

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PART 150—LIMITS ON POSITIONS

22. The authority citation for part 150 continues to read as follows:

Authority: 7 U.S.C. 6a, 6c and 12a(5)(1988).

23. Section 150.3 is amended by revising paragraph (a)(4)(i)(D) to read as follows:

§ 150.3 Exemptions.

(a) * * *

(4) * * *

(i) * * *

(D) Solicit funds for such trading by separate Disclosure Documents that meet the standards of § 4.24 or § 4.34 of this chapter, as applicable, where such Disclosure Documents are required under part 4 of this chapter.

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Issued in Washington, DC, on July 14, 1995, by the Commission.

Jean A. Webb,

Secretary of the Commission.

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