

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.<sup>34</sup> 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.<sup>35</sup> 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

<sup>34</sup> 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.

<sup>35</sup> 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.

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;<sup>36</sup> 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

<sup>36</sup> 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.