

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 Analysis⁴⁶

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 Disclosure 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 Disclosures⁵⁰

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

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

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.