

a. Capsule Performance Presentation:  
Rule 4.25(a)(1) <sup>52</sup>

*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"),<sup>53</sup> 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,<sup>54</sup> 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

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

<sup>52</sup> 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.

<sup>53</sup> 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).

<sup>54</sup> 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.

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.<sup>55</sup>

<sup>55</sup> As noted above, the Commission is reviewing the subject of "notional funds" performance data with the benefit of industry, end-user, regulatory

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<sup>56</sup> and to maintain records substantiating such computations in accordance with Rule 1.31.<sup>57</sup> 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

and academic input provided at the Commission's April 25, 1995, roundtable discussion and other available data.

<sup>56</sup> 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 previously 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.

<sup>57</sup> 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.