

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.