

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 Act⁹⁶ 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 compositing 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 systematic program that recommends specific transactions."