

"liquidity" as a risk factor, in recognition that the risk of illiquidity is one that arises in a wide range of instruments and that liquidity issues may often be linked to the other identified risk factors.

Rule 4.24(g) as adopted provides three contexts in which such risks should be considered, the trading programs to be followed, the trading structures to be employed and the investment activity expected to be engaged in by the offered pool. Risk factors specific to each context should be discussed. For example, this discussion should indicate any material historical or expected volatility of the trading program and any other special characteristics of the trading program, such as concentration in a particular commodity, lack of trading history, or negative performance history associated with the trading program. The trading structures or vehicles to be employed may also present significant risks. For example, multi-CTA and multi-investee-fund structures generally involve more complex fee structures than other pools and their profit potential may be adversely affected as a result of the potential for the pool to maintain offsetting positions due to the separate trading of various CTAs and investee funds. The specific types of investment activity in which the pool is expected to engage must also be examined to identify principal risk factors. For example, highly leveraged off-exchange transactions such as some types of swaps, may present risks of rapid price movements, illiquidity, lack of transparency and the potential for counterparty default which may not be material in the context of domestic exchange-traded futures contracts. Given the wide range of potential pool investments, the CPO must determine on a case-by-case basis what risk factors must be addressed in light of the contemplated trading and investment activity of the pool.

A CPO must make a determination whether the risks affecting each investee pool (or investee fund), when considered in the context of the investor pool's participation in such investee pool (or fund), constitute principal risk factors of the investor pool. In determining whether counterparty creditworthiness is a principal risk factor in the context of a given pool offering or trading program, factors such as the use of instruments other than those that are traded on United States contract markets must be considered.¹⁶⁰

4. Investment Program and Use of Proceeds: Rule 4.24(h) for CPOs¹⁶¹

Proposed Rule 4.24(h) would have consolidated under the caption "Use of Proceeds" the provisions of former Rule 4.21(a)(1)(viii), which required a description of the types of commodity interests the pool is expected to trade and any restrictions on such trading, with those of former Rule 4.21(a)(9), which required disclosure of the manner in which the pool would fulfill its margin requirements and the form in which non-margin funds would be held. As a result, taken together, former Rules 4.21(a)(1)(viii) and (a)(9) called for disclosure of both the commodity interest trading expected to be engaged in by the pool and all other types of trading, investments, custodial arrangements and other uses of the funds of the pool. Proposed Rule 4.24(h) thus would have unified previously separate related disclosures to create a single, cogent discussion of all of the contemplated uses of pool funds. In addition to integrating disclosures previously required under separate rule provisions, Proposed Rule 4.24(h) was designed to reflect the increasingly diverse nature of non-futures investments made by pools, for example, interests in other commodity pools, commercial paper and foreign securities.

Several commenters recommended that use of proceeds disclosure requirements minimize (or eliminate) information regarding "normal" investment uses and concentrate on (or be limited to) "unusual" uses of assets or uses that present special risks to the investor. Several commenters argued that expanded use of proceeds disclosures have unnecessarily lengthened Disclosure Documents, resulting in disproportionate emphasis on standard or mundane investments and obscuring the pool's primary business objectives. Some commenters urged that the use of pool assets in securities trading that is independent of rather than incidental to a pool's commodity interest trading should not require disclosure. With respect to participation in investee pools or funds, one commenter suggested that only a general statement that the pool would invest in investee pools or funds should

subject to some of the same risks as over-the-counter transactions.

¹⁶¹ Because of the differences between CPOs and CTAs, the Commission did not propose nor is it now adopting any general "use of proceeds" disclosure requirement for CTAs. However, both new Rules 4.24(h)(2) for CPOs and Rule 4.34(h) for CTAs require a description of the trading program that will be used for the pool or managed account client.

be sufficient. Another commenter suggested that the requirement for use of proceeds disclosure should be based upon the percent of assets allocated to the investee pool and that if the investment involved less than ten percent of the offered pool's assets, disclosure should not be required. Two commenters criticized the requirement to disclose whether (and in what form) assets are held in segregation.

Based upon its review of the comments received and of the overall content of the proposed and final rules, the Commission has determined to modify proposed Rule 4.24(h) in order to provide greater clarity and specificity as to the disclosures called for. In essence, proposed Rule 4.24(h) was designed to elicit a description of the types of interests in which the proceeds of the offering would be invested and of the trading programs to be followed. To better reflect the overall intent and scope of this provision, it has been retitled "Investment Program and Use of Proceeds" and the text has been restructured and refined to provide more specific guidance as to the minimum disclosures called for. As revised, Rule 4.24(h) calls for four main types of information: Information about the types of commodity interests and other interests which the pool will trade; a description of the trading and investment programs and policies that will be followed by the offered pool; a summary description of the pool's commodity trading advisors and investee pools or funds; and information concerning the manner in which the pool will fulfill its margin requirements, the approximate percentage of the pool's assets that will be held in segregation and related matters. With respect to each topic, explanatory text has been added to clarify the types of information to be provided. For example, information concerning the "types of commodity interests or other interests the commodity pool operator intends that the pool will hold or trade" is to include the approximate percentage of the pool's assets that will be used to trade commodity interests, securities and other types of interests. The provision also calls for the different types of interests in which the pool will trade to be categorized so as to provide a meaningful explanation of the contemplated trading and investment portfolio. Thus, the rule provides for categorization by the type of commodity or market sector, type of security, whether traded or listed on a regulated exchange market, maturity ranges, and investment rating, as applicable. Further, the regulatory status of such

¹⁶⁰ As shown by the recent events involving the collapse of Barings, PLC, under certain circumstances exchange-traded instruments may be